



**BILLING CODE: 8070-01-P**

**Federal Housing Finance Agency**

**12 CFR Part 1231**

**RIN 2590-AA72**

**Golden Parachute and Indemnification Payments**

**AGENCY: Federal Housing Finance Agency.**

**ACTION: Notice of Proposed Rulemaking.**

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**SUMMARY:** The Federal Housing Finance Agency (FHFA) is proposing to amend its rule on golden parachute payments to better align the rule with areas of FHFA's supervisory concern and reduce administrative and compliance burdens. The current rule requires FHFA review and consent before a regulated entity or the Office of Finance (OF) enters into an agreement to make, or makes, a payment that is contingent on the termination of an affiliated party, if the regulated entity or OF is in a troubled condition, in conservatorship or receivership, or insolvent. FHFA's experience implementing the rule indicates that the rule requires review of some agreements and payments where there is little risk of excess or abuse, and thus that it is too broad.

If amended as proposed, the rule would focus on the types of agreements and payments that are of greater supervisory concern to FHFA. In general, these are payments to and agreements with executive officers, broad-based plans covering large numbers of employees (such as severance plans), and payments made to non-executive-officer employees who may have engaged in certain types of wrongdoing. The proposed

amendments would also revise and clarify definitions, exemptions, and procedures to implement FHFA's supervisory approach. Where possible, FHFA would also align procedures and outcomes of review under the Golden Parachute Payment Rule with requirements of FHFA's rule on executive compensation. FHFA expects implementation of these changes would result in reduced administrative and compliance burdens.

**DATES:** Comments must be received by [INSERT DATE 45 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** You may submit your comments on the proposed rule, identified by regulatory information number (RIN) 2590-AA72, by any one of the following methods:

- *Agency website:* [www.fhfa.gov/open-for-comment-or-input](http://www.fhfa.gov/open-for-comment-or-input).
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by e-mail to FHFA at [RegComments@fhfa.gov](mailto:RegComments@fhfa.gov) to ensure timely receipt by FHFA. Include the following information in the subject line of your submission: Comments/RIN 2590-AA72.
- *Hand Delivered/Courier:* The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA72, Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street, SW, Washington, D.C. 20219. Deliver the package at the Seventh Street entrance Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.
- *U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service:* The mailing address for comments is: Alfred M. Pollard, General Counsel,

Attention: Comments/RIN 2590-AA72, Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street, SW, Washington, D.C. 20219. Please note that all mail sent to FHFA via U.S. Mail is routed through a national irradiation facility, a process that may delay delivery by approximately two weeks. For any time-sensitive correspondence, please plan accordingly.

**FOR FURTHER INFORMATION CONTACT:** Alfred Pollard, General Counsel, (202) 649-3050, *Alfred.Pollard@fhfa.gov*; Lindsay Simmons, Assistant General Counsel, (202) 649-3066, *Lindsay.Simmons@fhfa.gov*; or Mary Pat Fox, Manager for Compensation, Division of Enterprise Regulation, (202) 649-3215, *MaryPat.Fox@fhfa.gov*. These are not toll-free numbers. The mailing address is: Federal Housing Finance Agency, 400 Seventh Street, SW, Washington, D.C. 20219. The telephone number for the Telecommunications Device for the Hearing Impaired is (800) 877-8339.

**SUPPLEMENTARY INFORMATION:**

**I. Comments**

FHFA invites comments on all aspects of the proposed rule and will take all comments into consideration before issuing a final rule. Copies of all comments will be posted without change, and will include any personal information you provide such as your name, address, e-mail address, and telephone number, on the FHFA website at <http://www.fhfa.gov>. In addition, copies of all comments received will be available for examination by the public through the electronic rulemaking docket for this proposed rule also located on the FHFA website.

## II. Background

FHFA has broad discretionary authority to prohibit or limit any “golden parachute payment,” generally defined as any payment, or any agreement to make a payment, in the nature of compensation by a regulated entity for the benefit of an “affiliated party” that is contingent on the party’s termination, when the regulated entity is in troubled condition, in conservatorship or receivership, or insolvent (a “troubled institution”).<sup>1</sup> This provision, at 12 U.S.C. 4518(e) (“Section 4518(e)”), was added to the Federal Housing Enterprises Financial Safety and Soundness Act (the Safety and Soundness Act) in 2008. Legislative history suggests it is intended to permit FHFA to prevent payments to departing employees and other affiliated parties that are excessive or abusive, could threaten (or further threaten) the financial condition of the troubled institution, or are inappropriate based on wrongdoing by the recipient.<sup>2</sup>

Section 4518(e) requires the Director to promulgate rules defining “troubled condition” and prescribing factors to be considered when prohibiting or limiting any “golden parachute payment,” and suggests some factors the Director may consider.<sup>3</sup>

FHFA first adopted a Golden Parachute Payments rule in 2008 as an Interim Final Rule with Request for Comments, which became final in 2009.<sup>4</sup> In response to comments

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<sup>1</sup> The “regulated entities” are the Federal National Mortgage Association (Fannie Mae) and any affiliate, the Federal Home Loan Mortgage Corporation (Freddie Mac) and any affiliate, (collectively, the Enterprises), and the Federal Home Loan Banks (the Banks). 12 U.S.C. 4502(20). The Office of Finance (OF) is a joint office of the Banks, to which FHFA extends the Golden Parachute Payments rule through its general regulatory authority. *See id.* sec. 4511(b)(2); *see also* 78 FR 28452, 28456 (May 14, 2013) and 79 FR 4394 (Jan. 28, 2014). In this notice, the terms “regulated entity” and “troubled institution” include the Enterprises, Banks, and OF, unless OF is otherwise expressly addressed.

<sup>2</sup> Section 4518(e) was based on a similar provision added to the Federal Deposit Insurance Act (FDI Act) in 1990, at 12 U.S.C. 1828(k). FHFA considers the legislative history of Section 1828(k) as a resource for interpreting Section 4518(e). *See generally*, 36 Cong. Rec. H783 (daily ed. March 14, 1990) and 136 Cong. Rec. H5882 (daily ed. July 30, 1990).

<sup>3</sup> *Id.* sec. 4518(e)(1) and (2).

<sup>4</sup> 73 FR 53356 (Sept. 16, 2008); *see also* 74 FR 5101 (Jan. 29, 2009).

received on the Interim Final Rule, FHFA proposed amendments to the rule in 2009 and 2013.<sup>5</sup> In response to comments received on those proposals, FHFA promulgated the current rule in 2014.<sup>6</sup>

To ensure that FHFA has an opportunity to review and, if necessary, prohibit or limit golden parachute payments and agreements before they are made, the current rule prohibits all golden parachute payments and agreements that are not exempt from or permitted by the rule. Prohibited agreements or payments may be permitted by the Director after review. The rule defines terms, addresses payments that are exempt from the “golden parachute payment” definition or are permitted by the rule, establishes a process for FHFA to determine the permissibility of any other golden parachute payment or agreement, and sets forth review factors used by the Director in that process.

Because the rule applies equally to golden parachute payments and agreements, it requires FHFA to determine the permissibility of prohibited agreements before they are entered into and of prohibited payments before they are made. In most cases, this means that a troubled institution must request FHFA’s prior review and consent to a payment that would be made in accordance with an agreement to which FHFA has already consented. This “double approval” requirement was recognized by FHFA and commenters when the rule was proposed in 2013 and finalized in 2014.<sup>7</sup> FHFA noted then that it was an appropriate supervisory approach where conditions could change after the agreement was approved (for example, the condition of a troubled institution could further deteriorate, or an intended recipient could be found to have contributed to the

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<sup>5</sup> See *id.* at 30975 (June 29, 2009); see also 78 FR 28452 (May 14, 2013).

<sup>6</sup> See 79 FR 4400 (Jan. 28, 2014).

<sup>7</sup> 78 FR at 28454; see also 79 FR at 4396.

deterioration or engaged in wrongdoing with a material adverse effect on the regulated entity).<sup>8</sup> In practice, that approach has resulted in FHFA’s receiving numerous requests for review of golden parachute payments and agreements.

Narrowly drafted exemptions from the rule have also given rise to numerous requests for review. For example, because severance pay plans of the regulated entities do not meet an exemption for “nondiscriminatory” plans, troubled institutions are not permitted to make severance payments to any employees – even small payments to low level employees – without FHFA review and consent. Likewise, an exemption for payments pursuant to a “bona fide deferred compensation plan or arrangement” does not apply or is lost if the plan is established or amended in the one-year period prior to the time the regulated entity became a troubled institution, meaning such plans and any plan payments must be reviewed by FHFA.

Based on FHFA’s review experience, FHFA has now determined that the scope of the current rule is too broad, insofar as it requires a troubled institution to request, and FHFA to review, agreements and payments where there is very little concern about an abusive or excessive payment or threat to the financial condition of the paying regulated entity, and little likelihood that the employee or other affiliated party receiving payment could have engaged in the type of wrongdoing that FHFA would consider as the basis for prohibiting or limiting an agreement or payment.

Separately, FHFA has also determined that the current Golden Parachute Payments rule could be harmonized with other requirements related to the compensation

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<sup>8</sup> *Id.*

of executive officers of the regulated entities, including termination payments.<sup>9</sup> These requirements are implemented through a separate FHFA rule on executive compensation, at 12 CFR part 1230 (the Executive Compensation rule).<sup>10</sup> FHFA's experience in applying both rules to such termination payments has suggested areas where processes and outcomes can be aligned, avoiding the need to request or engage in separate reviews.

Having considered FHFA's statutory authority and its experience implementing the Golden Parachute Payments and Executive Compensation rules, FHFA is proposing to amend the Golden Parachute Payments rule to better balance FHFA's supervisory concerns for golden parachute payments with the rule's administration and compliance burdens. FHFA invites comments on all aspects of the proposed amendments and will take all comments into consideration.

### **III. Summary of Proposed Amendments**

#### **A. Overview**

In general, FHFA has higher supervisory concern for golden parachute payments to and agreements with executive officers than lower ranking employees, because executive officers hold positions of greater responsibility and influence within a company. FHFA also has a higher supervisory concern for agreements, and in particular

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<sup>9</sup> Specifically, FHFA is required to prohibit any regulated entity from providing compensation to an executive officer that is not "reasonable and comparable with compensation for employment in other similar businesses . . . involving similar duties and functions." 12 U.S.C. 4518(a). "Compensation" is broadly defined by statute, and includes termination payments. *Id.* sec. 4502(6); *see also* 74 FR 26989, 26990 (June 5, 2009); 78 FR 28442, 28443 (May 14, 2013); and 79 FR 4389 (Jan. 28, 2014). In addition, the Enterprises may not enter into an agreement to provide any termination payment to an executive officer unless FHFA has approved the agreement in advance, after determining that it meets a comparability standard. 12 U.S.C. 1452(h)(2) and 1723a(d)(3)(B).

<sup>10</sup> Among other things, that rule requires the regulated entities to provide notice to FHFA prior to entering into any compensation arrangement with, or paying compensation to, any "executive officer," including compensation in connection with an executive officer's termination. The regulated entity may provide the compensation if FHFA affirmatively provides a non-objection or approval, or does not prohibit it, within a stated review period. 12 CFR 1230.3 and 1230.4.

for broad-based agreements or plans such as severance plans, than for a subsequent payment in accordance with a plan or agreement. A broad-based agreement or plan typically covers numerous employees, bases the amount to be paid on criteria such as job level or length of employment, and provides for payments based on the occurrence of stated events. When reviewing the plan, FHFA can assess whether proposed payments to employees as members of a defined class or group would be excessive for that class or group (for example, whether a severance payment determined by job level and length of service is excessive for that level and service term). In addition, FHFA can assess the cumulative impact on the regulated entity if the same event were to occur for many employees at the same time or over a short time span, resulting in a high aggregate payout (for example, a severance plan that provides payments on involuntary termination not for cause may result in a high aggregate payment for a significant reduction in force). Finally, FHFA has a higher supervisory interest in payments to employees where there is a concern that the employee may have engaged in wrongdoing that had a material effect on the financial condition of the regulated entity or in certain financial crimes, or may be substantially responsible for the regulated entity's becoming a troubled institution. Review in such cases can inform FHFA of the employee's possible conduct and whether additional supervisory action may be appropriate.

To better reflect these supervisory policies, FHFA proposes to amend the rule to distinguish agreements from payments, executive officers from other affiliated parties, and affiliated parties for whom there is a concern about wrongdoing from those for whom there is not. Generally, the amended rule would require a troubled institution to obtain prior review of and consent for (1) most agreements with and payments to executive



officers; (2) most agreements with employees who are below the executive officer level (including plans covering such employees); and (3) most payments to employees who are below the executive officer level, where the regulated entity has concerns that the employee may have engaged in certain types of wrongdoing.

FHFA has also reviewed the current rule for clarity and has determined that several changes could make it easier to understand and apply. These include relocating exempt payments and agreements, which do not require FHFA review or consent, from the rule's definitions section to its substantive provisions and changing rule terminology that could be confusing. FHFA also considered consistency with the treatment of compensation agreements with and payments to executive officers under the Executive Compensation rule, because the Executive Compensation and Golden Parachute Payment rules can overlap in some cases. FHFA expressly desires to align procedures and outcomes where possible, thereby further reducing administrative and compliance burdens.

#### **B. Golden Parachute Agreements and Payments Subject to Review**

FHFA proposes to retain the rule's current approach and require FHFA review of golden parachute agreements and payments unless they are expressly permitted by the rule. This framework serves to notify a troubled institution that, if an agreement or payment is not exempt from the definition of "golden parachute payment" or permitted by the terms of the rule, then the troubled institution must obtain FHFA's consent prior to entering into the agreement or making a payment.

Fundamentally, the current approach requires an understanding of the scope of the "golden parachute payment" definition – whether an agreement or payment is subject to

review under the rule first turns on whether it is covered. In that regard, FHFA is clarifying its interpretation of “golden parachute payment” and proposing some amendments to the rule definition.

First, the statutory definition addresses payments (including agreements) “in the nature” of compensation.<sup>11</sup> FHFA interprets this phrase to expand upon the meaning of “compensation” and to include payments that are not traditionally understood as wages earned or money paid for services performed by an employee in connection with employment. As one example, FHFA interprets “golden parachute payment” to include individually negotiated settlement agreements and associated payments. There the amount paid may involve potential damages from claims arising out of the employment relationship and so may relate to compensation, though it may also include valuation of litigation risk, reputation risk, and other costs and fees.

The current rule definition addresses any “golden parachute payment” that is “contingent on the termination of [a party’s] affiliation with the regulated entity” (as the statute provides) as well as any such payment that is “by its terms payable on or after” termination.<sup>12</sup> The latter phrase was added when the rule was first adopted to address the possibility of a regulated entity’s evading a “golden parachute payment” by simply making a payment to a party after, but not contingent on, termination.

However, some payments received after termination, such as payments that would have been provided to the employee during the employment period had an intervening event (termination) not occurred, do not become “golden parachute payments” merely because of the timing of payment. Two examples of such payments are the last payment

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<sup>11</sup> 12 U.S.C. 4518(e)(4)(A).

<sup>12</sup> Compare *id.* sec. 4518(e)(4)(A)(i) and 12 CFR 1231.2.

of earned salary and cashed out accrued but unused vacation benefits. FHFA has provided these interpretations to troubled institutions in the past, but has not previously published them. To avoid suggesting that the timing of a payment alone – on or after termination – causes the payment to be a “golden parachute payment,” and to ensure an appropriate nexus between the occurrence of termination and the golden parachute payment, FHFA proposes to replace the phrase “by its terms is payable on or after termination” with the phrase “is contingent on or provided in connection with” termination. FHFA requests comment on this proposed amendment.

FHFA is also proposing other amendments to the rule definition. As noted above, the statutory “golden parachute payment” definition covers both payments and agreements to make payments, clearly permitting FHFA to prohibit or limit both an agreement to make a payment and, separately, the payment itself. FHFA now proposes to amend the rule to establish outcomes or treatments that depend on whether a troubled institution is entering into an *agreement* to make a golden parachute payment or is making a *payment*. In contrast, the current rule definition of “golden parachute payment” follows the form of the statutory definition, which includes within “golden parachute payment” *both* payments and agreements and thus makes it difficult to address one in a manner distinct from the other. FHFA now proposes to remove reference to “any agreement” from the rule’s “golden parachute payment” definition and use the terms “golden parachute payment agreement” or “agreement to make a golden parachute payment” when specifically referring to such agreements. This amendment is not intended to change the scope of the rule, which will continue to cover both golden parachute agreements and payments. FHFA is also proposing a definition of an

“agreement” to make a golden parachute payment, which is intended to be broad and clarify that the term includes broad-based plans such as severance plans, as well as agreements that are individually negotiated with an affiliated party.

FHFA also proposes to remove the phrase “pursuant to an obligation of the regulated entity or the Office of Finance” from the rule’s “golden parachute payment” definition. The statutory definition addresses payments that are “pursuant to an obligation” of the regulated entity, made by the regulated entity when it is a troubled institution.<sup>13</sup> FHFA’s current rule definition reflects the statute and includes reference to an “obligation” – but where Section 4518(e) clarifies that FHFA’s authority to prohibit or limit payments *includes* those made pursuant to an obligation, using the phrase “pursuant to an obligation” within the rule could be construed as limiting its application to payments that a troubled institution is contractually obligated to make. This is not FHFA’s intention.

FHFA’s experience implementing the current rule has been that the overwhelming majority of golden parachute payments are the subject of an “obligation.” However, FHFA does not interpret Section 4518(e) or its current rule as impeding FHFA’s ability to prohibit or limit improper payments that are not pursuant to an “obligation.” As safety and soundness supervisor for the regulated entities, FHFA could always prohibit (or limit) improper gifts or contributions to an affiliated party,<sup>14</sup> and it is inconsistent with the policy of Section 4518(e) to interpret it or FHFA’s implementing rule as permitting excessive or abusive payments that are made gratuitously, not pursuant to an obligation. Indeed, FHFA has interpreted the current rule as covering gifts, and troubled institutions

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<sup>13</sup> 12 U.S.C. 4518(e)(4)(A).

<sup>14</sup> See generally, 12 U.S.C. 4511(b)(2), 4513(a)(1), 4513b, and 4526.

have requested FHFA's review of and consent to proposed retirement gifts. Nonetheless, FHFA requests comment on its proposal to remove the phrase "pursuant to an obligation of the regulated entity or the Office of Finance" from the rule definition of "golden parachute payment."

FHFA also notes that the statutory and rule definitions include any payment that would be a "golden parachute payment" but for the fact it was made before the paying regulated entity became a troubled institution, if the payment was made "in contemplation of" becoming a troubled institution.<sup>15</sup> FHFA is proposing to amend the rule to include a rebuttable presumption that any payment that would otherwise be a "golden parachute payment," made within the 90-day period prior to a regulated entity's becoming a troubled institution, is made "in contemplation of" and thus will be treated as a "golden parachute payment." FHFA proposes the timeframe of 90 days prior because the events that would cause a regulated entity to become a troubled institution – becoming in troubled condition (which the rule defines with reference to examination ratings of 4 or 5 or initiation of certain enforcement actions), appointment of FHFA as conservator or receiver, or becoming insolvent – usually are not events that occur suddenly, without any prior awareness by the regulated entity of its deteriorating condition and FHFA's increasing supervisory concern. FHFA also finds support for a 90-day timeframe in the federal bankruptcy code, where a somewhat analogous provision would permit the avoidance of certain transfers made within 90 days prior to the filing of a bankruptcy petition.<sup>16</sup>

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<sup>15</sup> *Id.* sec. 4518(e)(4)(B); *see also* 12 CFR 1231.2.

<sup>16</sup> *See generally*, 11 U.S.C. 547.

Since the presumption is rebuttable, a regulated entity need not request review of any agreements or payments made within the 90-day period where there is a reasonable basis for concluding that such agreements or payments were not made “in contemplation of” becoming a troubled institution. On the other hand, FHFA also expects that if a regulated entity took a more conservative approach and sought FHFA review of agreements and payments made during the 90-day period, the actual number of review requests would not increase materially. Pursuant to its obligations for oversight of executive compensation, FHFA must review agreements with and payments to executive officers regardless of their timing relative to the regulated entity’s becoming a troubled institution. There may be a slight increase in the number of requests for review of plans or agreements with other employees, but FHFA review and consent in those cases could be stabilizing to the regulated entity as it works to improve its condition (because employees may be reassured that any promised payments on termination would be permissible even if the condition of the regulated entity continued to deteriorate).

FHFA is proposing one change to the “golden parachute payment” definition to improve its readability. Currently, the statute defines “golden parachute payment” with reference to a regulated entity that has experienced a triggering event: the regulated entity is in troubled condition (as defined by FHFA by regulation); FHFA has been appointed conservator or receiver for the regulated entity; or the regulated entity has become insolvent.<sup>17</sup> Following the form of the statute, the rule incorporates the listed triggering events, including “troubled condition,” into its definition of “golden parachute payment.” Separately, the rule defines “troubled condition.”

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<sup>17</sup> 12 U.S.C. 4518(e)(4)(A)(ii).

This rule construct has the effect of dividing the triggering events between two definitions and also makes it difficult to refer to a regulated entity that has experienced a triggering event. FHFA proposes to amend the “golden parachute payment” definition to cover payments made by a regulated entity that is, or is in contemplation of becoming, a “troubled institution,” and proposes to add “troubled institution” as a newly defined term that will list all of the triggering events, including those that previously defined “troubled condition.” The current rule’s definition of “troubled condition” would be removed. FHFA believes that this approach would continue to meet the statutory requirement that FHFA define “troubled condition” by regulation, but would result in a rule that is easier to understand.

FHFA requests comment on the preceding proposed amendments to the “golden parachute payment” definition.

### **C. Exempt Agreements and Payments**

Agreements and payments that are exempt from the “golden parachute payment” definition are not subject to the Golden Parachute Payment rule.<sup>18</sup> Because statutory exemptions are presented as exemptions from the “golden parachute payment” definition and because that definition covers both agreements and payments, FHFA interprets statutory exemptions expressed in terms of *payments* as extending to both the payment and any agreement to make it. As noted above, however, FHFA is now proposing to remove reference to any “agreement” from the “golden parachute payment” definition,

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<sup>18</sup> These payments may be subject to other rules, however. For example, the Executive Compensation rule generally requires the regulated entities to provide notice to FHFA prior to providing compensation to an executive officer, and requires FHFA to prohibit compensation that does not meet a statutory “reasonable and comparable” standard. Payments (or agreements to make payments) that are exempt from the “golden parachute payment” definition could be – and likely would be – “compensation” for purposes of the Executive Compensation rule.

which could imply that an exemption for a specific type of payment is operative only as to the *payment*, and that an agreement to make an exempt payment is not, itself, exempt. FHFA is clarifying here that an exemption for a payment extends to any plan or agreement to make that payment. The proposed rule text supports this interpretation, as it would prohibit an agreement to make a “golden parachute payment” and, conversely, would not prohibit any agreement to make a payment that is not a “golden parachute payment,” *i.e.*, a payment that is exempted from the “golden parachute payment” definition.

FHFA is also clarifying that it interprets the statutory “golden parachute payment” definition as not covering indemnification payments. Thus, rule provisions on golden parachute payments and agreements do not apply to indemnification payments.

Generally, it may be possible to construe indemnification payments as “golden parachute payments,” through interpretation of the phrase “in the nature of compensation” (where an indemnification payment arises from the party’s affiliation with a regulated entity and would reimburse the affiliated party for expenses he would otherwise bear) and application of the current rule definition to payments made after an affiliated party’s affiliation is terminated (where a termination agreement could include the troubled institution’s promise of indemnification in future actions arising from the party’s affiliation). FHFA also notes, however, that payment of indemnification is contingent on a legal action and, similar to a last salary payment after termination, is an expense that could have been incurred and paid during the period of affiliation. Thus, FHFA does not view either indemnification agreements covering payments to be made,



or actual indemnification payments that are made, after termination as “contingent on termination.”

FHFA also observes that Section 4518(e) addresses “indemnification payments” separately from “golden parachute payments” but does not exempt such payments from the statutory “golden parachute payment” definition. FHFA interprets this construct as demonstrating the assumption that it was not necessary to exempt indemnification payments because those types of payments were never viewed as within the “golden parachute payment” definition. Thus, instead of reading Section 4518(e) as carving out from the “golden parachute payment” definition only the subset of “indemnification payments” that Section 4518(e) expressly addresses, FHFA believes it is more plausible that Section 4518(e) applies separately to golden parachute payments and indemnification payments, such that “golden parachute payment” should not be construed to cover indemnification payments in general. Indemnification in actions brought by the agency are covered by the indemnification rule<sup>19</sup>; other indemnification is covered by the agency’s corporate governance rule and the applicable corporate law to which that rule points.

FHFA is addressing this interpretation in the preamble rather than the rule to avoid suggesting that indemnification payments are “golden parachute payments.” Specifically, FHFA believes that amending the rule to exempt or permit indemnification payments and agreements would imply such payments are “golden parachute payments,” which is not what FHFA intends. FHFA requests comment on this interpretation, and on

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<sup>19</sup> See generally, 81 FR 64357 (Sept. 20, 2016) (FHFA Notice of Proposed Rulemaking on indemnification payments).

the decision to address it in the preamble as an interpretation, instead of through a rule amendment.

Beyond that interpretation, FHFA proposes to amend exemptions currently set forth in the rule. FHFA proposes amendments to exemptions for any “bona fide deferred compensation plan or arrangement,” certain tax qualified retirement or pension plans, and “benefit plans.” FHFA also proposes to remove an exemption for nondiscriminatory severance pay plans or arrangements and to make a minor change to a separate exemption for other severance or similar payments. Finally, FHFA proposes to retain without change an exemption for payments made because of the affiliated party’s death, or termination caused by disability.

“*Bona fide deferred compensation plans or arrangements.*” Section 4518(e) exempts “any payment made pursuant to a bona fide deferred compensation plan or arrangement” that the Director determines, by regulation or order, to be “permissible.”<sup>20</sup> The current rule implements this provision with an exemption for deferred compensation plans or arrangements that meet certain conditions.<sup>21</sup> One condition – that the plan or arrangement was in effect for at least one year prior to the regulated entity’s becoming a troubled institution – was intended to avoid exempting instances where a regulated entity acted to enrich its executives officers or other high ranking employees when it was in deteriorating condition (thereby potentially rewarding those who were best positioned to have avoided the financial problems, or draining resources that could be used to improve condition or be made available to creditors if necessary).<sup>22</sup>

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<sup>20</sup> 12 U.S.C. 4518(e)(4)(C)(ii).

<sup>21</sup> 12 CFR 1231.2.

<sup>22</sup> *Id.*

In practice, failure to meet this condition has had the effect of eliminating the exemption for any otherwise “bona fide” deferred compensation plan that is established or amended by the regulated entity within the year prior to its becoming, or at any time when it is, a troubled institution, even if the plan or any amendment would not be objectionable to FHFA. Eliminating the exemption means that FHFA must review the revised plan and, even if FHFA determines the plan to be permissible, must also review all subsequent payments pursuant to it.<sup>23</sup> This imposes administrative and compliance burdens on FHFA and a regulated entity that could be avoided by amending the exemption so that it would cover any plan that meets all of the exemption’s conditions other than the timing requirement, and that FHFA has reviewed and determined to be permissible. FHFA is now proposing that amendment, and requests comments on it.

FHFA also notes that it has a separate statutory obligation to prohibit a regulated entity from providing compensation to an executive officer, including compensation in connection with termination of employment that is not reasonable and comparable with compensation for employment in other similar businesses involving similar duties and responsibilities.<sup>24</sup> FHFA implements this obligation through its Executive Compensation rule, which requires a regulated entity to provide advance notice to FHFA prior to entering into certain deferred compensation agreements with, or making certain deferred

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<sup>23</sup> On an ad hoc basis, under the current rule FHFA has consented to subsequent payments at the same time as it consented to a plan or agreement.

<sup>24</sup> See 12 U.S.C. 1452(h)(2), 1723a(d)(3)(B), and 4518(a). Indeed, for the Enterprises, an agreement to make a payment or provide benefits to an executive officer in connection with termination of employment is statutorily prohibited unless FHFA approves it in advance, after making a determination that the payments and benefits are comparable to those for officers of other public and private entities involved in financial services and housing interests with comparable duties and responsibilities. *Id.* sec. 1452(h)(2) and 1723a(d)(3)(B).

compensation payments to, executive officers.<sup>25</sup> Because FHFA is statutorily required to prohibit a regulated entity from providing compensation to an executive officer if it is not reasonable and comparable, FHFA review and approval of (or non-objection to) a deferred compensation plan covering executive officers is an effective pre-condition to application of the Golden Parachute Payments rule exemption. In other words, for executive officers, only those plans or other agreements that FHFA determines are reasonable and comparable *could* be exempt from the Golden Parachute Payments rule; plans or agreements that FHFA determines are not reasonable and comparable *must* be prohibited, without regard to any exemption from the Golden Parachute Payments rule.

*Certain tax qualified retirement or pension plans.* Section 4518(e) includes a statutory exemption for “any payment made pursuant to a retirement plan which is qualified (or intended to be qualified) under [section 401 of the Internal Revenue Code (IRC)].”<sup>26</sup> The rule includes this exemption and expands on it, to include any payment made “pursuant to a pension or other retirement plan that is governed by the laws of any foreign country.”<sup>27</sup> FHFA is not aware of any pension or retirement plan of any regulated entity that is or would be governed by the laws of any foreign country. Further, were FHFA to determine that a pension or retirement plan of any of its regulated entities is “governed by the laws of any foreign country,” FHFA would like to better understand the requirements of the governing law when considering the application of the Golden Parachute Payment rule to such a plan (understanding that, in the event a foreign law applied and required a payment, it may not be feasible to prohibit a troubled institution

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<sup>25</sup> See generally, 12 CFR part 1230.

<sup>26</sup> 12 U.S.C. 4518(e)(4)(C).

<sup>27</sup> 12 CFR 1231.2.

from making it). For these reasons, FHFA proposes to remove the rule’s exemption for such payments. FHFA requests comments on the impact, if any, to the regulated entities of removing this exemption.

*Benefit plans.* Section 4518(e)’s exemption related to qualified retirement plans continues, stating that it also applies to payments made pursuant to “other nondiscriminatory benefit plan[s].” On its face, this provision is a statutory exemption for “nondiscriminatory benefit plans” *other than* the tax qualified plans already expressly exempted. Beyond that, however, Section 4518(e) does not address the types of benefit plans intended to be outside the scope of a “golden parachute payment.”

FHFA’s current rule exempts any “benefit plan” and, separately, any “severance pay plan” that meets certain conditions and is “nondiscriminatory.”<sup>28</sup> To inform its understanding of the statutory exemption, FHFA has researched relevant legislative history and statutory provisions, including provisions of the IRC on the specified tax qualified plans. While that review did not reveal any generally accepted definitions of “nondiscriminatory” and “benefit plan,” it did suggest an interpretive approach that would look, in part, to whether a plan or program is a “nondiscriminatory employee plan or program” for purposes of IRC provisions on excess parachute payments.

Specifically, FHFA is proposing to exempt from the “golden parachute payment” definition any employee plan or program that is a “nondiscriminatory employee plan or program” in accordance with Internal Revenue Service (IRS) rules and published guidance interpreting 26 U.S.C. 280G.<sup>29</sup> Similar to Section 4518(e), IRC section 280G

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<sup>28</sup> *Id.*

<sup>29</sup> See 26 U.S.C. 280G; see also 26 CFR 1.280G-1. Legislative history of the FDI Act provision on which Section 4518(e) was modeled indicates that the FDI Act definition of “golden parachute payment” was

addresses parachute (termination) payments: it generally prohibits corporations from deducting as compensation that portion of a parachute payment due to change in control that is “excess,” and establishes rules for determining any such “excess” portion. Those rules permit a corporation to exclude from the “parachute payment” calculation any amounts that the corporation establishes by clear and convincing evidence are (1) “reasonable” compensation for services that were rendered on or after the date of the change in control and (2) compensation that was not contingent on the change in control. IRS regulations interpreting Section 280G state that the fact that payments were received pursuant to a “nondiscriminatory employee plan or program” is clear and convincing evidence that the compensation was reasonable and not contingent on change in control, and list those employee plans and programs that are “nondiscriminatory.”<sup>30</sup> FHFA now proposes to exempt any employee plan or program that is “nondiscriminatory” for purposes of IRC Section 280G from the definition of “golden parachute payment.” FHFA believes that this proposal will clarify those plans and programs that are exempt because they are “nondiscriminatory” and is consistent with the intention of Section 4518(e).

In conjunction with this amendment, FHFA is proposing to remove an exemption for “usual and customary [benefit] plans such as dependent care, tuition reimbursement, group legal services or cafeteria plans” and to add whether a benefit plan is “usual and customary” to the factors for the Director’s consideration when reviewing requests for consent to a plan. Thus, a regulated entity would be required to seek FHFA’s consent for

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informed by an IRC provision on “excess parachute payments” at 26 U.S.C. 280G, where a “parachute payment” is defined in part as “any payment in the nature of compensation . . . if such payment is contingent on” a change in the ownership or effective control of the corporation. *See* H.R. 4268 (unenacted) 101 Cong. (2<sup>nd</sup> Sess. 1990) and 136 Cong. Rec. H783 (daily ed. March 14, 1990).

<sup>30</sup> 26 CFR 1.280G-1, Q/A26(c).

a benefit plan that is not otherwise exempt from the rule, and FHFA could determine the plan to be permissible after considering, among other factors, whether the plan is “usual and customary.” FHFA believes this change will not materially affect the operation of the rule regarding such plans for two reasons. First, because the rule’s current exemption relies on the characterization of a plan as “usual and customary,” troubled institutions have sought FHFA’s concurrence that specific plans are considered “usual and customary,” which has resulted in a *de facto* review and consent process.<sup>31</sup> Similarly, under the proposal, a regulated entity could request FHFA’s review of and consent to a plan that is “usual and customary.” Second, most of the plans listed in the current rule as examples of “usual and customary plans” are included within the list of “nondiscriminatory employee plans and programs” for purposes of IRC Section 280G. If a benefit plan that would previously have been exempt as a “usual and customary” plan meets the IRC standard for “nondiscriminatory,” then that plan would now be exempt on the basis that it is “nondiscriminatory.”

Distinguishing between exempt “nondiscriminatory employee plans and programs” and plans that FHFA may permit as a matter of discretion because they are usual and customary (among other considerations) appears to align more closely with the language of Section 4518(e). Under this approach, a “nondiscriminatory employee plan or program” will be exempt even if it is not “usual and customary.”

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<sup>31</sup> In that regard, if FHFA has previously reviewed a specific plan and determined it to be “usual and customary” under the current rule, then that plan is exempt under the current rule and that exemption will be grandfathered under the rule if amended, unless the plan is materially amended. If a plan is materially amended, it will be viewed as if the regulated entity is discontinuing the exempt plan and establishing a new one, which would then be subject to the requirements and procedures of the rule as amended.

FHFA also recognizes that there may be benefit plans that are nondiscriminatory, but are not included within the IRS list of “nondiscriminatory employee plans and programs.” Because Section 4518(e) exempts all “nondiscriminatory benefit plans” from the “golden parachute payment” definition, FHFA is proposing to amend its process for requests for review to expressly address a request for an exemption for any other “benefit plan” that the regulated entity believes is “nondiscriminatory.” In that case, the regulated entity would be permitted to submit a single request that includes a request for exemption, in which the regulated entity must address the basis for its assertion that the plan is “nondiscriminatory,” and a request for consent. Based on the information in that submission, FHFA would determine if the plan is “nondiscriminatory;” if so, it would be exempt, and if not, FHFA would then determine whether it should nonetheless be a permissible golden parachute agreement. FHFA proposes this approach to better implement Section 4518(e)’s express exemption for “other nondiscriminatory benefit plans” and to reduce burdens on the regulated entity.

A regulated entity could request an exemption for any benefit plan it believes is “nondiscriminatory.” FHFA is proposing to remove the rule’s current definition of “nondiscriminatory” and is not proposing to establish a new definition. The current definition is applicable only to “severance pay plans” as defined in the rule, and it is not clear that any single “nondiscriminatory” definition would be appropriate for all types of plans. Having one definition for all plans may mistakenly result in some plans being treated as if they are subject to the rule, where in fact they should be exempt because they are “nondiscriminatory.” FHFA also believes that considering whether a particular plan



is nondiscriminatory in conjunction with the plan’s design and purpose would aid FHFA in carrying out the purposes of Section 4518(e).

Nonetheless, FHFA believes that the rule’s current definition of “nondiscriminatory” identifies appropriate criteria for assessing discrimination, such as length of service, salary, total compensation, job grade, or classification. These criteria are similar to some used for IRS “nondiscriminatory employee plans and programs.”<sup>32</sup> When a regulated entity requests an exemption for a “nondiscriminatory” benefit plan, it will be required to demonstrate how the plan operates to achieve a nondiscriminatory outcome, where the discrimination of concern is between groups or classes of employees, and higher level or more highly compensated employees are disproportionately advantaged over lower level or less highly compensated employees. In particular, a plan that provides disproportionately greater benefits to some employees based solely or primarily on level or position within a regulated entity (or any proxy for level or position such as total salary or total compensation, job grade, or classification) would not likely be determined “nondiscriminatory” by FHFA. Differences in the level of benefits provided based on other objective criteria such as length of service, or on level or position in combination with such other criteria, may be nondiscriminatory.

Finally, the current rule’s definition of “benefit plan” includes (and thus exempts from the “golden parachute payments” definition) those “employee welfare benefit plans” as defined by section 3(1) of the Employee Retirement Income Security Act of 1974

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<sup>32</sup> See, e.g., 26 U.S.C. 79(d), where the nondiscrimination test considers, among other factors, provision of the benefit to “key” employees, defined with reference to title and level of compensation; and sec. 129, where the test considers the relative compensation of eligible participants (highly compensated employees and non-highly compensated employees) and average level of benefits provided to highly compensated employees relative to non-highly compensated employees.

(ERISA), at 29 U.S.C. 1002(1). FHFA is not proposing to amend this exemption, though it would be relocated.

FHFA understands that some ERISA employee welfare benefit plans must meet statutory nondiscrimination tests, and thus are exempt from the “golden parachute payment” definition by the express terms of Section 4518(e). FHFA also believes that many such plans are simply not covered by the statutory “golden parachute payment” definition. Specifically, though the benefit provided to the employee – the opportunity to participate in such a plan – is “in the nature of compensation,” FHFA believes it is unlikely that benefit is “contingent on the [employee’s] termination of . . . affiliation with the regulated entity.” Instead, FHFA believes it is more likely that such benefits are provided based on the condition of employment (affiliation) but may continue after termination, either through the terms of the actual employee welfare benefit plan, or through the terms of a severance agreement. In the latter instance, FHFA would construe the benefit as contingent on termination. Because severance pay plans or agreements are not exempt from the golden parachute payment definition, however, FHFA would have the opportunity to review those agreements or plans, including any extended employee welfare benefits they provide.

FHFA requests comment on all aspects of its proposed amendments to the rule’s current treatment of “benefit plans”; the proposed process for requesting either an exemption, for a plan believed to be “nondiscriminatory,” or consent, if FHFA determines that a plan is not “nondiscriminatory”; removal of the rule’s current definition of “nondiscriminatory”; and its treatment of employee welfare benefit plans.

*Nondiscriminatory severance pay plans or arrangements.* FHFA is also proposing to remove from the rule an exemption for severance pay plans that meet the rule definition of “nondiscriminatory” and other conditions. Implementing the current rule resulted in FHFA’s reviewing the severance pay plans of troubled institutions and, based on that experience, FHFA has determined as a matter of supervisory policy that severance pay plans should be subject to review.

FHFA review of troubled institution severance pay plans was required because these plans did not meet the current rule’s “nondiscriminatory” definition and thus were not exempt. Instead, troubled institutions requested FHFA’s consent to such plans, and FHFA made decisions applying the rule’s consideration factors. FHFA has determined this review is very useful for assessing the potential or intended impact of the plan on the troubled institution, given its specific circumstances. Where the plan covers a described event, *e.g.*, involuntary termination not for cause, that entitles employees to severance pay and that could occur for many employees at the same time or close in time, the troubled institution may be subject to making a higher, aggregated payout. That same event – numerous involuntary terminations not for cause, happening close in time – may be appropriate to address a financial weakness, however. Likewise, an appropriately structured severance pay plan could have a retentive effect on employees that could be stabilizing as a troubled institution works to improve its financial condition. Because the circumstances and strategies of each troubled institution would likely be different, severance pay plans with different terms and structures could be appropriate.

For these reasons, FHFA believes that these plans should be reviewed, as a result of which they may be permitted – or even deemed exempt, if determined to be

nondiscriminatory based on a request for exemption by the troubled institution. FHFA notes that severance pay plans are not currently included in the IRS list of “nondiscriminatory employee plans and programs,” but also that it is possible for the list to evolve to include them through amendments to the IRC or IRS interpretation. In that case, severance pay plans that meet specifically applicable IRC or IRS “nondiscrimination” requirements would be exempt from the FHFA rule without the need for an exemption request. This treatment is consistent with FHFA’s proposed approach to applying Section 4518(e)’s statutory exemption for “other nondiscriminatory benefit plans.”

FHFA requests comment on the proposed removal of the current rule’s exemption for severance pay plans that are “nondiscriminatory” and meet other conditions.

*Other severance or similar payments required by state or foreign law.* The current rule also includes an exemption for certain severance or similar payments that are required to be made by state statute or foreign law.<sup>33</sup> As with the rule’s exemption for payments made pursuant to pension or other retirement plans “governed by the laws of any foreign country,” described above, FHFA is not aware of any severance or similar payments that any regulated entity would be required to make by foreign law. Were FHFA to determine a severance or similar payment was required by a foreign law, FHFA would like to better understand the requirements of that law when considering the application of the Golden Parachute Payments rule to such a payment (again, understanding that if a foreign law applied and required a payment, that it may not be feasible to prohibit a troubled institution from making it). For these reasons, FHFA

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<sup>33</sup> 12 CFR 1231.2.

proposes to remove the rule’s exemption for such payments, and requests comments on the impact to the regulated entities of removing it.

#### **D. “Executive Officers” and Other “Affiliated Parties”**

Under the current rule, agreements and payments that are within the definition of “golden parachute payment” may be permitted, either by operation of the rule or after review and consent by FHFA.<sup>34</sup> Although that approach would continue if the rule is amended as proposed, whether an agreement or payment is permitted by operation of the rule (meaning, without review and consent by FHFA) could now turn on whether it is provided to an “executive officer” or another type of “affiliated party.” Proposals related to those definitions are addressed below. As a technical matter, however, FHFA is first proposing a change to the rule’s terminology, specifically, to change the term “entity-affiliated party” to “affiliated party.”

Section 4518(e) defines a “golden parachute payment” in part as a payment, including an agreement to make a payment, to an “affiliated party.” “Affiliated party” is not defined by statute, though a similar statutory term, “entity-affiliated party,” used primarily in the context of FHFA’s enforcement authority, is defined.<sup>35</sup> FHFA considered the statutory definition of “entity-affiliated party” when interpreting “affiliated party” and uses the term “entity-affiliated party” in the current rule, although the rule definition of “entity-affiliated party” is different from the statutory definition.<sup>36</sup>

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<sup>34</sup> *Id.* § 1231.3(b).

<sup>35</sup> 12 U.S.C. 4518(e)(4); *see also id.* sec. 4502(11).

<sup>36</sup> *Compare* 12 U.S.C. 4502(11) and 12 CFR 1231.2.

“Entity-affiliated party” is also used and defined in FHFA’s rules of practice and procedure, at 12 CFR part 1209. To avoid confusion and because Section 4518(e) uses the term “affiliated party,” FHFA is proposing to change the term “entity-affiliated party” to “affiliated party” throughout part 1231.

FHFA is also proposing substantive changes to the definition of “affiliated party” for purposes of rule provisions related to “golden parachute payments.”<sup>37</sup> For the most part, the current rule does not establish different treatments or outcomes based on the party to whom a golden parachute payment could be made, but applies in kind to each defined “entity-affiliated party.” One provision – an exemption for payments made pursuant to nondiscriminatory severance pay plans (which FHFA has proposed to remove for other reasons, set forth above) – does not apply to any “executive officer” whose annual base salary exceeds a stated amount. Within that provision, “executive officer” is defined by reference to FHFA’s Executive Compensation Rule. Because FHFA now proposes to amend the rule to more broadly distinguish the treatment of executive officers from the treatment of other “entity-affiliated parties,” FHFA is also proposing to more generally incorporate in this rule the definition of “executive officer” from FHFA’s Executive Compensation rule.

FHFA has also identified other issues with the rule definition of “entity-affiliated party” that it proposes to address. Specifically, for the regulated entities, the current rule includes parties to whom it is unlikely that excessive or abusive termination payments

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<sup>37</sup> Section 4518(e) and 12 CFR part 1231 also address “indemnification payments,” the statutory definition of which also uses the term “affiliated party.” *See* 12 U.S.C. 4518(e)(5)(A); *see also* 81 FR 64357 (Sept. 20, 2016). If part 1231 is amended as proposed, the term “affiliated party” would be used throughout the rule, but it would be defined differently depending on whether the payment is an indemnification payment or a golden parachute payment.

would be made. For OF, the current rule defines “entity-affiliated party” more narrowly than for FHFA’s regulated entities.

If amended as proposed, the definition of “affiliated party” for purposes of golden parachute payments would cover all employees, officers, and directors of a regulated entity or OF, and any other party the Director, by regulation or on a case-by-case basis, determines to be participating in the conduct of the affairs of a regulated entity or OF. For the regulated entities, as applied to golden parachute payments, the “affiliated party” definition would be narrower on its face but its potential scope would not change, as it would retain the “catch-all” that permits FHFA to deem parties other than directors, officers and employees to be “affiliated parties.” For OF, the amended definition would be broader. Each of these proposed changes is described below.

*“Affiliated parties” of the regulated entities.* The statutory definition of “entity-affiliated party” – any controlling stockholder for, or agent of, any regulated entity; any shareholder, affiliate, consultant, or joint venture partner of a regulated entity; any independent contractor (including an attorney, appraiser or accountant) who meets certain conditions; and any not-for-profit corporation that receives its principal funding from a regulated entity – is largely incorporated into the current rule definition of “entity-affiliated party.” While it could be appropriate in some instances to treat any listed party as an “affiliated party,” FHFA does not believe it is likely that these parties would receive payments that are contingent on their termination or that are abusive or excessive, and thus does not believe it is necessary to treat each of them as an “affiliated party” as a matter of course. This is particularly true since the rule, like the statute, includes a “catch-all” provision for “any other person that the Director determines, by regulation or

on a case-by-case basis, to be participating in the conduct of the affairs of the regulated entity.”<sup>38</sup> That provision is a more flexible and targeted tool for ensuring that FHFA appropriately reviews payments by a troubled regulated entity that are contingent on the termination of the affiliation of a party who is not a director, an officer, or an employee.

For these reasons, FHFA proposes to remove listed parties other than directors, officers, and employees from the rule’s definition. The “catch-all” provision would be retained, though it would be slightly amended to incorporate a provision of the current rule that states a member of a Bank shall not be deemed an “affiliated party” solely because it is a shareholder of, or obtains advances from, a Bank.

*“Affiliated parties” of OF.* The Safety and Soundness Act definition of “entity-affiliated party” includes the Office of Finance.<sup>39</sup> For purposes of the Golden Parachute Payments rule, however, FHFA determined that OF should be treated as if it were a “regulated entity” (meaning, as if it were the paying party, instead of the party receiving payment).<sup>40</sup> This decision required FHFA to develop a rule definition of OF’s “entity-affiliated parties,” which currently covers any director, officer or manager of OF. It does not cover other OF employees or include the “catch-all” for parties participating in the conduct of OF’s affairs.

FHFA continues to believe that OF should be treated as a “regulated entity” for purposes of golden parachute payments and agreements. FHFA does not believe OF employees should be outside the rule’s scope, however. There is no supervisory policy that supports excluding any OF employees and, further, no supervisory policy that

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<sup>38</sup> 12 CFR 1231.2.

<sup>39</sup> 12 U.S.C. 4502(11).

<sup>40</sup> See 74 FR at 30976 and 78 FR at 28456.



supports a different definition of “affiliated party” for OF than for the regulated entities. Thus, to ensure that OF is treated similarly to any “regulated entity” for purposes of the rule, FHFA proposes to remove the rule’s separate definition of “entity-affiliated party” for OF and to apply the same “affiliated party” definition, amended as described above, to any regulated entity and OF. This change expands the scope of the rule with regard to OF, as it would now cover OF employees and any other person the Director determines, by regulation or on a case-by-case basis, to be participating in the conduct of the affairs of OF. FHFA requests comment on these proposed changes.

*Definition of “executive officer.”* To implement FHFA’s decision to distinguish some agreements or payments that are provided to an “executive officer” from those that are provided to other “affiliated parties,” it is necessary to define “executive officer.” FHFA proposes to incorporate the definition of “executive officer” for purposes of its Executive Compensation rule, because the regulated entities and OF are familiar with that definition and FHFA intends that “executive officer” be defined consistently for the two rules.<sup>41</sup>

For the Enterprises and the Banks, the Executive Compensation rule’s definition of “executive officer” includes “any individual who performs functions similar to such positions, whether or not the individual has an official title” and, for any regulated entity and the OF, “any other officer as identified by the Director.”<sup>42</sup> Any individual or other officer who is considered an “executive officer” for purposes of the Executive Compensation rule would also be treated as an “executive officer” for the Golden Parachute Payments rule.

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<sup>41</sup> See 12 CFR 1230.2.

<sup>42</sup> *Id.*

FHFA further notes that the Executive Compensation rule establishes different “executive officer” definitions for the Enterprises, the Banks, and OF.<sup>43</sup> For the Enterprises, the rule definition is based on a Safety and Soundness Act definition that applies only to the Enterprises and includes two Enterprise directors: the chairman and vice chairman of the board of directors.<sup>44</sup> Because these Enterprise directors are treated as “executive officers” for purposes of the Safety and Soundness Act and the Executive Compensation rule, FHFA also proposes to treat them as “executive officers” for this rule. Other Enterprise directors, all directors of any Bank, and all directors of the OF would be treated as other affiliated parties, unless FHFA determines any such other director should also be treated as an “executive officer.” In practice, this means that, under the proposal, more agreements with and payments to directors (other than the Enterprises’ chairmen and vice chairmen) would be permitted by operation of the rule and thus could be made without FHFA prior review and consent (assuming certain conditions, which are discussed below, are met).

FHFA also believes that it could be appropriate for any affiliated party to be treated as an “executive officer” for purposes of the Golden Parachute Payments rule, based on the affiliated party’s degree of influence or level of responsibility. For that reason, the proposal would allow the Director to designate any affiliated party as an “executive officer” for purposes of the Golden Parachute Payments rule. FHFA

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<sup>43</sup> *Id.* Enterprise executive officers are the chairman and vice chairman of the board of directors, the chief executive officer, chief financial officer, chief operating officer, president, any executive vice president, any senior vice president, any individual in charge of a principal business unit, division, or function, and any individual who performs functions similar to such positions whether or not the individual has an official title. Bank executive officers are the president, the chief financial officer, and the three other most highly compensated officers. OF executive officers are the chief executive officer, chief financial officer, and chief operating officer. In all cases, “executive officer” includes any other officer identified by the Director.

<sup>44</sup> 12 U.S.C. 4502(12).

anticipates basing such decisions on consideration of whether the affiliated party's participation in the conduct of the affairs of the regulated entity is of such influence or responsibility that the party could materially affect decisions about termination payments or the financial condition of the regulated entity, or could engage in certain types of financial crimes (identified in the rule).

FHFA expects to address whether a party who becomes an "affiliated party" as a result of the "catch-all" provision should be treated as an "executive officer" at the same time it determines to apply the "catch-all." However, FHFA reserves the right to make a determination that an affiliated party should be treated as an "executive officer" for purposes of the rule at any time (in that case, the determination would not be applied retroactively, such that agreements or payments previously entered into or made could be in violation of the rule. Instead, FHFA would review future payments, including any agreement pursuant to which payment is made, as payments arise).

FHFA requests comments on all aspects of its proposed definition of "executive officer."

#### **E. Permitted Agreements**

As previously noted, the approach of the current rule – that agreements and payments not exempted from the definition of "golden parachute payment" are prohibited unless they are permitted, either by operation of the rule or after review and consent by FHFA– would continue in the rule as proposed to be amended. To implement FHFA's intention to distinguish the treatment of agreements from the treatment of payments in some cases, the rule would be amended to address agreements and payments separately.

In addition, FHFA proposes to add three types of agreements that would be permitted by operation of the rule – (1) compensation arrangements (including plans or agreements) that are directed by FHFA exercising authority conferred by 12 U.S.C. 4617, which covers FHFA’s conservatorship and receivership authorities and authorities with regard to any limited life regulated entity (“LLRE”)), (2) individually negotiated settlement agreements with affiliated parties who are not executive officers, where certain conditions are met, and (3) agreements to make payments to affiliated parties other than executive officers, where the amount of the payment is *de minimis*. FHFA also proposes to remove the current rule’s provisions for permissible agreements with persons hired to prevent a regulated entity from imminently becoming a troubled institution or materially improve the financial condition of a troubled institution and change in control agreements, which FHFA now proposes to address in conjunction with other severance agreements. These proposed amendments are addressed below.

*Plans directed by the Director.* A regulated entity becomes a troubled institution for purposes of the Golden Parachute Payments rule if FHFA is appointed as its conservator or receiver (among other reasons). That appointment confers additional powers on FHFA: By operation of law, as conservator or receiver FHFA succeeds to the powers of the regulated entity’s board of directors and may operate the regulated entity, including establishing or directing the regulated entity to establish compensation plans and arrangements and to make provisions for payments on termination of employees.<sup>45</sup>

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<sup>45</sup> *Id.* sec. 4617(b)(2)(A) through (D).

Appointment as receiver also authorizes or requires FHFA to organize an LLRE for the regulated entity in receivership.<sup>46</sup> Although an LLRE is not in conservatorship or receivership, the Director has statutory discretion to use the agency's conservatorship and receivership authority with respect to the LLRE to establish or direct the establishment of employee compensation plans and provide for termination payments.<sup>47</sup>

Where FHFA, exercising authority conferred by 12 U.S.C. 4617, acts to direct the establishment of a compensation arrangement by a regulated entity, including an LLRE, the Director's consent to that arrangement is conveyed by the direction to establish it. For that reason, FHFA proposes to amend the Golden Parachute Payments rule to permit troubled institutions to make compensation plans or agreements that provide for termination payments to affiliated parties of a regulated entity without FHFA review, when such arrangements are established or directed by FHFA pursuant to authority conferred by 12 U.S.C. 4617. FHFA requests comments on this amendment.

*Individually negotiated settlement agreements.* FHFA proposes to amend the rule to permit troubled institutions to enter into individually negotiated settlement agreements with affiliated parties other than executive officers without FHFA prior review and consent, where (1) the agreement resolves a claim by the affiliated party or avoids a claim that the troubled institution has a reasonable belief would be brought by the party, and involves payment to the affiliated party and the party's termination; and (2) at the time the agreement is entered into, the regulated entity is reasonably assured, following due diligence appropriate to the level and responsibilities of the affiliated party, that the party

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<sup>46</sup> *Id.* sec. 4617(i).

<sup>47</sup> *Id.* sec. 4617(i)(2)(C), providing that FHFA, in its discretion, may treat a limited-life regulated entity as a regulated entity in default at such times and for such purposes as FHFA determines.

has not engaged in certain types of wrongdoing. Individually negotiated settlement agreements with executive officers and other types of individually negotiated agreements with any affiliated party (such as, for example, an agreement with an employee to accelerate a retention award) would continue to require FHFA's prior review and consent.

This proposed amendment reflects FHFA's interpretation, addressed above, that the "golden parachute payment" definition covers a settlement agreement involving payment to and termination of an employee of a troubled institution, as an agreement to make a payment "in the nature" of compensation. It also recognizes that such agreements with lower ranking employees are not likely to involve payments that are excessive or abusive. Specifically, where a claim has been brought or a troubled institution reasonably believes one may be brought, the employee and the regulated entity have interests that are opposed. That opposition and the negotiation involved in reaching the settlement agreement provide some assurance that the agreement's terms, including any negotiated payment, are not excessive or abusive but instead reflect a cost to the troubled institution that it reasonably believes is lower than would likely be incurred if the claim were litigated.

Conversely, there is a somewhat higher supervisory concern that executive officers, who are better positioned to influence negotiations and decision-making and who could have built relationships with those in charge of negotiating or approving settlements, could receive payments through individually negotiated settlement agreements that do not fairly reflect an assessment of risk, potential damages, and associated costs, and thus that are excessive or abusive. On that basis, individually

negotiated settlement agreements with executive officers would continue to be subject to review by FHFA.

Limiting application of the amendment to “individually negotiated settlement agreements” requires defining that term. Consistent with the foregoing discussion, FHFA is proposing a definition that seeks to capture only those individually negotiated agreements that (1) settle a claim that an affiliated party has brought or avoid a claim the regulated entity reasonably believes the affiliated party would bring and (2) involve a settlement payment to the affiliated party, a release of claims by the party (and possibly the regulated entity), and the termination of the party’s affiliation with the regulated entity. As payment and termination are already included in the “golden parachute payment” definition, FHFA is not repeating them in its proposed definition of an “individually negotiated settlement agreement.” FHFA intends the definition to cover those agreements where obtaining a settlement and release of claims significantly motivates negotiation between the regulated entity and the affiliated party, as distinguished from other individual agreements where a release of claims is an important but more incidental feature. FHFA requests comment on the proposed definition of “individually negotiated settlement agreement.”

In order for an individually negotiated settlement agreement to be permissible without FHFA prior review and consent, the regulated entity must be reasonably assured, at the time the agreement is entered into, that the affiliated party has not engaged in certain types of wrongdoing. The types of wrongdoing that a regulated entity must consider are set forth in the current rule and are not changing.<sup>48</sup> To implement this

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<sup>48</sup> 12 CFR 1231.3(b)(1)(iv)(A) through (D).

condition, FHFA proposes to amend a certification requirement in the current rule that would otherwise apply. FHFA has identified issues with that requirement which it now proposes to address.

Specifically, under the current rule a regulated entity submitting a request for FHFA review of a proposed golden parachute payment or agreement must “demonstrate that it does not possess and is not aware of any information, evidence, documents, or other materials that would indicate that there is a reasonable basis to believe” that the person to whom payment would be made has engaged in any of the types of wrongdoing listed. This standard could imply that the regulated entity must have a high degree of certainty about the person’s actions, gained through considerable investigation, which may not be reasonable or, in some cases, even possible. For example, the current rule requires the regulated entity to provide certification when requesting review of an agreement, even where the parties to whom payment could ultimately be made are not known and would be expected to change over time (*i.e.*, employees covered by a broad-based severance pay plan). In addition, because the current rule states that each request must include a certification that a regulated entity is not aware of information that would reasonably indicate the party has engaged in wrongdoing, it could imply that a regulated entity that is not able to make the certification may not request FHFA’s review and thus may not enter into the agreement or make the payment. This outcome was not intended, as the preamble that accompanied the current rule made clear.<sup>49</sup> Indeed, a regulated entity may have concerns about wrongdoing that it desires to address through an

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<sup>49</sup> 79 FR at 4397.



individually negotiated settlement agreement to avoid litigation, and the rule is not intended to prevent this.

To address these issues, FHFA proposes to amend the current rule's certification requirement. First, FHFA is clarifying the standard that a requesting regulated entity must meet: It must be reasonably assured that the affiliated party has not engaged in wrongdoing listed in the rule, following appropriate due diligence. FHFA expects that the nature of the due diligence performed by a regulated entity will vary based on the opportunity of the affiliated party to engage in the types of wrongdoing listed, when considering the party's affiliation, duties, functions, and privileges. It is possible that some affiliated parties would have no opportunity to engage in any listed wrongdoing, and in that case, simply noting an assessment of "no opportunity" could be sufficient. A regulated entity may make an affirmation or similar statement by the terminating affiliated party a component of its due diligence process. When an appropriate due diligence process does not give cause for concern that the affiliated party may have engaged in the rule's listed types of wrongdoing, the "reasonably assured" standard is met. The standard does not require a regulated entity to demonstrate or prove that the affiliated party has not engaged in wrongdoing.

If the regulated entity determines that the "reasonably assured" standard is met, it may enter into an individually negotiated settlement agreement with an affiliated party other than an executive officer without FHFA's review and consent. The regulated entity should retain records necessary to support its application of the standard in accordance with 12 CFR part 1235. If the regulated entity cannot meet the "reasonably assured" standard, it must obtain FHFA's consent to enter into the agreement. FHFA is also

proposing to require any regulated entity that concludes, after appropriate due diligence, that it is not “reasonably assured” the affiliated party has not engaged in the listed types of wrongdoing to provide notice of its concerns to FHFA, even if the regulated entity does not enter into the individually negotiated settlement agreement. This requirement is intended to balance FHFA’s supervisory concern about the occurrence of wrongdoing listed in the rule with the desire of the regulated entity to resolve claims (or potential claims) by affiliated parties.

FHFA requests comments on all aspects of its proposed amendments related to individually negotiated settlement agreements with affiliated parties who are not executive officers.

*Agreements to make de minimis golden parachute payments.* FHFA is also proposing to amend the rule to permit a troubled institution to enter into an agreement to make a *de minimis* golden parachute payment to an affiliated party other than an executive officer without FHFA review and consent, and without conducting due diligence that the rule would otherwise require. The current rule does not distinguish agreements (or payments) based on amount, which has required troubled institutions to request FHFA review and consent even for agreements to make small golden parachute payments. Based on that experience, FHFA has determined that the burden of administration and compliance is not warranted, where the agreement would provide for a payment that is small and subject to a regulatory cap (thereby avoiding excessive or abusive payments or payments that would threaten the financial condition of the regulated entity) and is to be made to an affiliated party who is not an executive officer. In combination, FHFA believes these conditions support a reasonable presumption that

the affiliated party either (1) was not in position to materially affect the financial condition of the regulated entity or engage in certain types of wrongdoing listed in the rule or (2) if the affiliated party was in such a position, that the payment does not settle a claim involving such wrongdoing.

This amendment would apply to individually negotiated agreements as well as plans that cover multiple employees, including broad-based plans, if the agreement or plan provides for payment that does not exceed the *de minimis* amount. FHFA intends this treatment to control even where the agreement is of a type that is specifically addressed in the rule. For example, a troubled institution would be permitted to enter into an individually negotiated settlement agreement to make a *de minimis* settlement payment to an affiliated party who is not an executive officer without FHFA's prior review and consent and without conducting due diligence related wrongdoing that is otherwise required by the rule. As the actual amount that a particular employee could receive may not be known until a payment obligation arises, agreements or plans that could result in an affiliated party receiving more than the *de minimis* amount would require FHFA's prior review and consent.

FHFA proposes \$2,500 as the cap for a golden parachute payment that a troubled institution could agree to make without FHFA review and consent. While it is possible that a higher or lower amount could be supported, FHFA's past experience indicates there is a significant likelihood that payments of \$2,500 or less would be permitted after review.

The *de minimis* cap applies to all golden parachute payments in the aggregate to the same affiliated party. Therefore, if an individual affiliated party will or could receive more than one golden parachute payment and, in the aggregate, those payments could

exceed the *de minimis* amount, then each of the payments would require FHFA review. For example, if a departing employee is to receive severance of \$2,000, and the regulated entity also chooses to waive repayment of a small debt in the amount of \$1,500, the troubled institution would be required to submit both agreements to FHFA for review. On the other hand, if a departing employee is receiving a severance payment of \$1,500 and waiver of a debt repayment of \$750, neither payment would require FHFA review because the total amount of \$2,225 falls under the *de minimis* cap of \$2,500.

To ensure the specific *de minimis* amount remains appropriate over time, considering changes in the economy, FHFA is also proposing that the amount be increased for inflation in accordance with the formula and methodology used for the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015.<sup>50</sup> For consistency with that Act, FHFA proposes to base the annual adjustment on the increase in the percentage, if any, by which the Consumer Price Index for all urban consumers (CPI-U) as published by the Department of Labor for the month of December exceeds the CPI-U for the month prior to the month of the final rule's publication in the Federal Register, which would then be rounded to the nearest whole dollar.<sup>51</sup> Thus, if the rule were published in June 2018, the CPI-U for the month prior to publication, May 2018, would be 251.588.<sup>52</sup> If a troubled institution were applying the rule's \$2,500 *de minimis* amount in June 2020, it would look to the monthly CPI-U published for December

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<sup>50</sup> 28 U.S.C. 2461 note. This Act requires FHFA, among other agencies, annually to adjust the civil monetary penalties it may impose for inflation, in accordance with the Act's requirements.

<sup>51</sup> Consumer Price Index, Economic News Release, Bureau of Labor Statistics, United States Department of Labor, <https://www.bls.gov/news.release/cpi.toc.htm> (last visited August 20, 2018). The index levels can also be found in monthly press releases. See, e.g., Consumer Price Index Summary, United States Department of Labor, Bureau of Labor and Statistics, <https://www.bls.gov/news.release/cpi.nr0.htm>.

<sup>52</sup> See, Consumer Price Index Summary, United States Department of Labor, Bureau of Labor and Statistics (June 12, 2018), [https://www.bls.gov/news.release/archives/cpi\\_06122018.htm](https://www.bls.gov/news.release/archives/cpi_06122018.htm).

2019. If the CPI-U index had risen to 257.119 in December 2019,<sup>53</sup> the troubled institution would divide 257.119 by 251.588 for a result of 1.021984355. This means there has been a percentage increase of 2.1984355 percent.<sup>54</sup> The troubled institution would then increase the \$2,500 *de minimis* amount by 2.1984355 percent (which is to multiply 2,500 by 1.021984355) for a result of \$2,554.96. This amount rounded to the nearest dollar would be \$2,555. The *de minimis* amount in the entire calendar year of 2020 would be \$2,555.

To facilitate use of the adjustment by troubled institutions, FHFA also proposes to permit troubled institutions to calculate it themselves and apply it accordingly. Thus, no action by FHFA would be required in order for a troubled institution to use an inflation-adjusted dollar value.

FHFA requests comment on all aspects of its proposed treatment of agreements to make *de minimis* golden parachute payments, including the aggregation of payments for purposes of calculating the *de minimis* amount and the proposed inflation adjustment.

*Employment agreements with turnaround specialists.* FHFA identified issues with the scope and application of rule provisions on employment agreements with persons hired to help a regulated entity address its problems (“turnaround specialists”). Currently, the rule provides that an agreement made in order to hire a person to become an affiliated party either at a time when the regulated entity is, or in order to prevent it

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<sup>53</sup> This number was created for purposes of the example.

<sup>54</sup> For the avoidance of doubt, the calculations used for the example are as follows: (1)  $257.119/251.588 = 1.021984355$ . (2)  $2500 * 1.02198355 = 2554.960888$ . (3) Rounding of 2554.960888 to the nearest dollar produces \$2,555.

imminently from becoming, a troubled institution, is permissible provided that the Director consents to the terms and amount of the golden parachute payment.

In addition, the current rule is not clear as to whether the Director's consent to the terms and amount of payment is required when the agreement is entered into or could be provided later, at the time the payment is made. The reason for treating these employment agreements differently from other types of agreements is to facilitate the hiring of a turnaround specialist to address the regulated entity's problems, when the regulated entity's condition could be a disincentive to joining the company. In that light, FHFA believes review and consent at the time of agreement would provide greater assurance to the regulated entity and the prospective hire that payments in connection with termination provided for in the agreement will be permitted. Review at the time of agreement also aligns with FHFA's higher supervisory concern for agreements, relative to subsequent payments made pursuant to an agreement to which FHFA has consented. FHFA also observes that such agreements often anticipate the departure of the turnaround specialist when particular tasks are completed or benchmarks are met, and in that case, for a turnaround specialist hired as an executive officer, review of the agreement is consistent with statutory obligations that require FHFA to prohibit a regulated entity from providing compensation to an executive officer that is not reasonable and comparable and the Enterprises to obtain FHFA approval prior to entering into agreements that provide for payment in connection with the termination of an executive officer.

Finally, the current rule does not make it clear how consent obtained at the time an agreement is entered into operates to trigger provisions of the rule if the regulated entity is not then a troubled institution. By statute, an agreement or payment is a "golden

parachute payment” if it is made by a regulated entity when it is, or is in contemplation of becoming, a troubled institution. However, as noted above, the current rule does not address FHFA’s interpretation of “in contemplation of.”

Several proposed revisions to the rule will address these issues. To clarify that FHFA intends to review any employment agreement with a turnaround specialist, FHFA is removing the rule’s current provision that permit such agreements. Within the rule’s general construct, agreements that are not permitted by operation of the rule cannot be entered into without FHFA’s review and consent; by removing the rule provision that makes such agreements permissible, FHFA is thus making them subject to its prior review.

That change will operate in conjunction with other amendments related to payments that are described below. If those proposed amendments are adopted, a troubled institution will be required to obtain FHFA’s consent to the employment agreement, but could be permitted to make payment to a turnaround specialist without further review or consent, provided (1) the payment is in accordance with the agreement, (2) the Director provided consent to the subsequent payment when providing consent to the agreement, and (3) the troubled institution meets any other condition that the Director imposed when providing consent. This proposed treatment of payments could apply to any employee who is hired as a turnaround specialist, including an executive officer.<sup>55</sup>

In FHFA’s view, a regulated entity that hires a turnaround specialist to prevent it from imminently becoming a troubled institution could meet the “in contemplation of”

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<sup>55</sup> FHFA also notes that termination payments to executive officers would be deemed “compensation” for purposes of the Executive Compensation rule. FHFA intends to coordinate its review of agreements to make such payments as required under each rule.

criteria and, if so, would become subject to all of the rule's provisions. It is also plausible that a regulated entity experiencing problems would seek FHFA's consent to a proposed employment agreement as though it were a troubled institution, to reassure a prospective employee that the agreement would not be prohibited should the regulated entity's condition deteriorate further. Nothing in the rule prevents this; where the rule requires a troubled institution to request FHFA's consent to an agreement, it does not preclude a regulated entity that is not a troubled institution from doing so. FHFA notes, however, that consent to an agreement is contextual, and it may not be feasible to consent to an agreement as though it were a golden parachute agreement, if there appears little likelihood that the regulated entity would become a troubled institution in the reasonably near term. FHFA requests comment on this proposed approach, and on all aspects of its proposed treatment of employment agreement with turnaround specialists.

*Change in control agreements.* FHFA is also proposing to remove from the rule a provision that addresses change in control agreements. Under the current rule, a troubled institution may enter into a change in control agreement that provides for a reasonable severance payment capped at the amount of the base salary paid to the employee in the previous 12 months without FHFA's prior review and consent. A change in control agreement that provides for payment on termination in excess of the cap requires FHFA's prior approval. Further, any change in control agreement that results from a regulated entity being placed into conservatorship or receivership also requires FHFA's prior review and consent.

The approach of the current rule, permitting some change in control agreements to be entered into without FHFA review, is not consistent with FHFA's supervisory concern



for agreements to make golden parachute payments, especially agreements to make payments to executive officers, or with FHFA's interest in reviewing agreements that provide severance pay. For those reasons, FHFA proposes to treat a change in control agreement as it would any other agreement under the rule as proposed to be amended. Thus, for example, any individually negotiated change in control agreement (whether with an executive officer or another affiliated party) would require FHFA's prior review and consent, as would any plan that included executive officers and provided for severance pay on a change in control. If a change in control agreement or plan provided for only a *de minimis* payment to an affiliated party other than an executive officer, then FHFA's prior review and consent to the agreement would not be required.

FHFA recognizes that a regulated entity may enter into agreements or establish severance pay plans that provide for payments on a change in control prior to the regulated entity becoming a troubled institution. A regulated entity does not violate the rule simply because FHFA has not provided consent to an agreement or plan that is in place at the time the entity becomes a troubled institution. FHFA anticipates that it would review such agreements or plans either at the time a regulated entity becomes a troubled institution or at the time a payment is proposed to be made. Since FHFA could then determine that the agreement or plan to make a golden parachute payment is not permissible, however, the regulated entities should address that contingency – possible future application of the rule – in their plans and agreements to avoid later contractual disputes.

FHFA requests comments on its proposed amendment to remove the rule's provision on change in control agreements and thereby require FHFA's prior review and

consent to change in control agreements and plans providing for golden parachute payments (other than a *de minimis* payment).

#### **F. Permitted Payments**

As is the case with golden parachute agreements, under the current rule a troubled institution may not make a golden parachute *payment* unless it is permitted by the rule or because the Director has consented to the payment after review. FHFA does not propose to change this general approach, but has identified some instances where it would be appropriate to permit payments to be made by operation of the rule. These instances reflect the supervisory policies previously stated, that FHFA has a higher supervisory concern for agreements than for a subsequent payment made pursuant to a permitted agreement, and a higher concern for payments to executive officers than it does for similar types of payments when provided to lower ranking employees.

To implement these policies, FHFA is proposing to permit a troubled institution to make a payment pursuant to a permitted individually negotiated settlement agreement to any affiliated party, including an executive officer, without further review and consent. This proposal acknowledges that the payment could be construed as essential consideration for the agreement, such that consent to the payment would be incorporated in the determination to permit an individually negotiated settlement agreement.

FHFA is also proposing to clarify the Director's authority to consent to any future payment to any affiliated party that would otherwise be subject to prior review, at the same time or after the Director consents to the plan or agreement pursuant to which the payment would be made, provided the payment is made in accordance with a permitted agreement (whether by operation of the rule or after FHFA review and consent) and

meets any other conditions that the Director may establish. This authority has been implicit in the rule, and would now be explicit.

FHFA is proposing to permit a troubled institution to make two other types of payments to affiliated parties who are not executive officers without FHFA review and consent. These are (1) *de minimis* payments and (2) payments above the *de minimis* amount that are made in accordance with a permitted agreement, where the troubled institution is reasonably assured, following appropriate due diligence, that the affiliated party has not engaged in wrongdoing of the types listed in the rule.

Finally, FHFA is proposing to permit a troubled institution to provide small value gifts to executive officers to recognize significant, nonrecurring, life events (such as retirement) without FHFA's review and consent.

All golden parachute payments other than those permitted by operation of the rule would be subject to FHFA review and consent.<sup>56</sup> As a result of the proposed amendments, which are discussed in more detail below, FHFA believes most payments to employees who are not executive officers would not require FHFA review and consent,

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<sup>56</sup> A recent case rejected a claim that a taking for purposes of the Tucker Act, 28 U.S.C. 1491, can occur when FHFA prohibits a golden parachute payment, including one made pursuant to an agreement entered into before the enactment of Section 4518(e) in 2008. In *Piszel v. U.S.*, 833 F.3d 1366 (Fed. Cir. 2016), the Court of Appeals for the Federal Circuit held that FHFA's prohibition did not result in a taking because the affiliated party retained the ability to pursue a claim for damages from the regulated entity for breach of contract.

FHFA agrees with the ruling that there was no taking, but observes that awarding damages in an action for breach of contract by an affiliated party against a regulated entity, where FHFA prohibits the regulated entity from making a golden parachute payment in accordance with its rule, would clearly defeat the purpose of Section 4518(e), which is to prevent the affiliated party from receiving such a payment.

In contrast, the Court of Federal Claims had held in that case that no taking occurred (see *Piszel v. U.S.*, 121 Fed. Cl. 793 (2015)) based on the lack of a sufficiently cognizable property interest in the context of the regulatory scheme ("a heavily regulated environment") and the regulator's express statutory authority (the Safety and Soundness Act in effect at the time of contract formation authorized FHFA's predecessor agency to prohibit compensation it deemed to be unreasonable at any time, and nothing in the Act "guaranteed that the government could not later change its mind" after approving the compensation). That conclusion would, of course, be even stronger with respect to a payment made subject to an agreement entered into after Section 4518(e)'s enactment, a proposition with which the Federal Circuit may have agreed, *see* 833 F.3d at 1374.

while many payments to employees who are executive officers would. FHFA review and consent would be required for any payment to any affiliated party where there is a basis for concern that the party has engaged in wrongdoing of a type listed in the rule.

*Payments pursuant to permitted individually negotiated settlement agreements.*

FHFA proposes to permit any payment pursuant to a permitted individually negotiated settlement agreement, to be made without further FHFA review. FHFA has previously described permitted individually negotiated settlement agreements, whether by operation of the rule (in the case of an agreement with an affiliated party other than an executive officer, where the troubled institution is reasonably assured, after appropriate due diligence, that the party has not engaged in certain types of wrongdoing) or after FHFA review and consent (in the case of an agreement with any executive officer, or with an affiliated party where the troubled institution is not reasonably assured that the party had not engaged in certain types of wrongdoing). FHFA understands that the settlement payment could be essential consideration for the agreement, and that the agreement could be viewed as nonbinding if there were a question as to whether the payment would be allowed or could be prohibited.

FHFA also recognizes that some timing issues could present interpretive questions. For example, an individually negotiated settlement agreement entered into before the regulated entity becomes a troubled institution, and when the regulated entity is not “in contemplation of” becoming troubled, could provide for future payments that may ultimately be made after the regulated entity becomes a troubled institution. In that case, FHFA would view the agreement as permitted for purposes of the rule, because at the time it was entered into, the rule did not apply to the agreement and thus it could not

be “impermissible” in the rule’s context. Because the agreement would be deemed permitted, payments pursuant to it would also be permitted.

*Payments where consent was provided with consent to an agreement.* With this provision, FHFA is making explicit authority that has been implied in the rule, that the Director can permit any golden parachute payment and thus can, as circumstances warrant, undertake the review process for a payment, or a set of payments, at the same time as review of an agreement. FHFA believes that there are instances where such consent could be appropriate as a matter of administrative efficiency and to reduce burden. For example, the Director may consent to a golden parachute payment when consenting to the agreement where the actual payment is expected to be made in a short timeframe. A regulated entity may request FHFA to consent to future payments, and FHFA may also determine that such consent is appropriate on its own initiative.

Because other proposed amendments would permit a troubled institution to make most payments to affiliated parties other than executive officers without FHFA review, FHFA expects this provision would most often be used with regard to payments to executive officers. FHFA also expects that consent in such instances would impose the condition that the troubled institution make the payment only if, after appropriate due diligence, it is reasonably assured that the executive officer has not engaged in wrongdoing of the types listed in the rule. Other conditions could also be imposed, such as the condition that payment be made within a certain time period. A troubled institution should establish an appropriate compliance process to ensure any conditions imposed on making the payment are met. If the troubled institution is not able to meet the conditions, it may submit the proposed payment to FHFA for review and consent.

FHFA requests comment on its proposal addressing concurrent review of and consent to any agreement to make a golden parachute payment to an affiliated party and any subsequent payment and conditions that must be met for a troubled institution to make such a payment without further FHFA review and consent.

*De minimis payments to affiliated parties other than executive officers.*

Consistent with the foregoing proposal on permitted agreements, FHFA is proposing to permit a troubled institution to make a *de minimis* golden parachute payment to any affiliated party other than an executive officer, without FHFA review and consent and without the due diligence otherwise required by the rule. If the *de minimis* payment is pursuant to a permitted agreement, this provision confirms that making the payment does not trigger any required action on the part of the troubled institution or FHFA. If a *de minimis* payment is made without any agreement between the parties – which FHFA views as unlikely – then this provision also serves to clarify that an agreement is not required in order to make it; rather, it is the *de minimis* amount of the payment that establishes its permissibility.

FHFA's proposal related to *de minimis* payments does not apply to payments to executive officers. Considering the purposes of Section 4518(e), FHFA believes that the majority of golden parachute payments to executive officers, even payments of relatively low amounts, should be subject to review. On the other hand, a proposed provision for small value gifts discussed below would apply to executive officers. As a result, a troubled institution would be permitted to provide a retirement gift to an executive officer without FHFA review, provided its value does not exceed the proposed small value cap.

FHFA also notes that, while the rule would not require any due diligence prior to making a *de minimis* payment, other governing documents may condition payment on employee behavior. For example, a plan that provides for a modest termination payment to employees whose length of service does not qualify them for severance pay may establish the condition that the employee not be terminated for cause. FHFA's proposal to relieve *de minimis* golden parachute payments from due diligence otherwise required by the rule does not impact conditions that are imposed by the terms of a plan or agreement.

FHFA requests comment on its proposal to permit troubled institutions to make *de minimis* golden parachute payments to affiliated parties other than executive officers, without conducting due diligence otherwise required by the rule and without FHFA review.

*Payments pursuant to other permitted agreements, to affiliated parties other than executive officers.* FHFA is proposing that payments made pursuant to permitted agreements other than individually negotiated settlement agreements, to an affiliated party other than an executive officer, and that exceed the *de minimis* amount, be permitted without further FHFA review provided the troubled institution is reasonably assured, following appropriate due diligence, that the affiliated party has not engaged in the types of wrongdoing listed in the rule. A payment in excess of the *de minimis* amount that is not pursuant to a permitted agreement, or where the troubled institution is not able to meet the "reasonably assured" standard, would require FHFA's review and consent.

Permitted agreements, the standard of "reasonably assured," and the standard of appropriate due diligence have been addressed above. Thus, the nature of due diligence

performed will vary (based on the opportunity of the affiliated party to engage in the types of wrongdoing listed, considering the party's affiliation, duties, functions, and privileges), and a regulated entity may make an affirmation or a similar statement by the affiliated party part of its due diligence process. When an appropriate due diligence process does not indicate a concern that the affiliated party may have engaged in the rule's listed types of wrongdoing, the "reasonably assured" standard is met, and the payment would be in accordance with a permitted agreement, then the troubled institution may make a golden parachute payment without FHFA review. The regulated entity should retain records necessary to support its decision in accordance with 12 CFR part 1235. If the troubled institution cannot meet the "reasonably assured" standard, it must obtain FHFA's consent to make the golden parachute payment. If the troubled institution concludes that the "reasonably assured" standard is not met and elects not to make the payment, it would be required to provide notice of its concerns to FHFA.

FHFA requests comment on all aspects of its proposed treatment of permitted payments to affiliated parties other than executive officers.

*Small value gifts to executive officers.* With some limited exceptions, the current rule operates to require FHFA review of all golden parachute payments to executive officers. The proposed rule would generally take a similar approach, as it would establish only three instances where a golden parachute payment to an executive officer would not require FHFA review and consent: payments pursuant to an individually negotiated settlement agreement, payments to which the Director consented when consenting to the agreement that provides for the payment (both discussed above), and small value gifts on the occurrence of a significant life event such as retirement.



Specifically, FHFA is proposing to permit a troubled institution to provide a small value gift to an executive officer without FHFA review, where the gift is provided in recognition of a nonrecurring life event such as retirement. This proposal reflects FHFA's balancing of the administrative and compliance burdens of reviewing such payments, and its determination that reviewing such payments, even when made to an executive officer, exceeds FHFA's level of supervisory concern where the payment is in an amount that does not suggest an evasion of the rule. For that reason, FHFA proposes to cap permissible gifts at \$500 or less. A gift exceeding \$500 would be subject to review.

To ensure that the small value gift provision remains at a relevant dollar amount FHFA is proposing an annual inflation adjustment in the same manner as proposed for *de minimis* payments. Thus, continuing the example previously set forth, if a troubled institution were applying the rule's \$500 small gift provision in June 2020, the \$500 amount would be increased by 2.1984355 percent for a result of \$510.99 (which rounded to the nearest dollar would be \$511) and the small gift cap for the entire calendar year of 2020 would be \$511.

FHFA requests comments on all aspects of the proposed treatment of small value gifts, including whether the provision should expressly cover any types of gifts, and if so, what types. FHFA also requests comment on the proposed inflation adjustment formula.

#### **G. Procedure for Requesting Consent**

The rule currently sets forth instructions for filing requests for consent, including the contents of a filing and to whom requests should be sent. In general, FHFA proposes to retain without change filing requirements related to the reason the troubled institution

seeks to enter into the agreement or payment; a requirement that the troubled institution provide a copy of any agreement regarding the subject matter of the request; the cost to the troubled institution of the proposed payment or payments and their impact on capital and earnings; and the reasons why FHFA should provide consent. FHFA is proposing a minor change to the content requirement related to the identity of the affiliated party to whom payment would be made, to clarify that a description of the class or group eligible for payment is required where the actual affiliated parties are not known or may change (as may be the case with a broad-based severance plan, for example). More substantive changes to the content of filing requirements, addressed below, generally align with other substantive proposed changes to the rule.

For example, to align with proposed changes related to “nondiscriminatory benefit plans,” FHFA proposes to add a requirement related to any benefit plan that the regulated entity believes is “nondiscriminatory” even though it is not listed among the IRS “nondiscriminatory employee plans and programs” explicitly exempted from the “golden parachute payment” definition. The regulated entity should support its assertion that the benefit plan is nondiscriminatory with a description of how it operates (or will operate) with regard to eligible participants at different levels of employment. If FHFA agrees that the plan is nondiscriminatory, then it will be exempt as a matter of law.

It is possible that FHFA would disagree with the regulated entity’s suggested characterization of an agreement (*i.e.*, that the agreement is a bona fide deferred compensation plan or arrangement, or is nondiscriminatory). In those instances, FHFA expects that it would then consider the request as if it had been submitted for FHFA’s general review and would notify the regulated entity both that FHFA disagreed with the

proposed characterization and whether the proposed agreement was permitted, nonetheless. The regulated entity could then determine either to implement the plan as originally submitted to FHFA (subject to meeting other rule requirements related to payments) or to revise the plan to address issues with the regulated entity's intended characterization (*e.g.*, that the plan is "nondiscriminatory") and re-submit it to FHFA.

FHFA is also proposing changes to a filing requirement related to a troubled institution's certification and documentation of factors related to wrongdoing. Under the current rule, a troubled institution is required to "demonstrate that it does not possess and it not aware of any information, evidence, documents or other materials that would indicate that there is a reasonable basis to believe" that the party to receive payment has engaged in four listed types of wrongdoing.

Because the rule does not distinguish golden parachute payments from agreements, certification is required for any request to FHFA, including a request for FHFA review of a broad-based plan covering a large and fluid number of employees. FHFA believes that approach as applied to plans and agreements is unnecessarily burdensome (and may be infeasible) if it requires the troubled institution to make a certification with regard to a class of affiliated parties, particularly considering that a similar analysis and certification is required prior to actually providing the golden parachute payment. For that reason, FHFA is proposing to require troubled institutions to undertake the rule's due diligence review only when entering into a golden parachute payment agreement with an individual affiliated party and when making any payment. In those cases, the affiliated party to whom payment would be made can be readily identified, making the review more meaningful and manageable.

FHFA has previously addressed amendments to clarify the applicable standard and the expected level of due diligence review by a troubled institution. For purposes of making a request for FHFA consent to an individual agreement or any payment, however, a troubled institution would now be required to state either that it is reasonably assured that any affiliated party identified in the request has not engaged in the listed types of wrongdoing or, if it is not reasonably assured, the results of its due diligence and, in light of those results, why the troubled institution believes FHFA should nonetheless provide consent. These changes are intended to clarify that a troubled institution may request FHFA's review and consent even if the "reasonably assured" standard is not met.

FHFA is also proposing minor changes to update the rule. For example, the rule currently refers to requests as "letter applications." FHFA now proposes to require simply that the request be in writing. FHFA also proposes to state expressly that it may waive or modify any form or content requirement. Thus, it could be appropriate for a troubled institution to make an oral request. Though the current rule does not prevent this, an express waiver provision would clarify that FHFA intends to be flexible where warranted by the circumstances of an agreement or payment.

Finally, nothing prevents a troubled institution from providing any other information it believes is relevant to its request, including information relevant to factors for FHFA's consideration that are set forth in the rule (and discussed further below). For example, a troubled institution may wish to note, and provide support for, its conclusion that a benefit plan is "usual and customary."

## **H. FHFA Review of Requests**

*Review Factors.* Section 4518(e) requires FHFA to set forth by regulation factors to be considered when acting to prohibit or limit a golden parachute payment or agreement, and suggests some factors that FHFA may consider.<sup>57</sup> In that context, the rule's prohibition of golden parachute payments is a procedural construct to ensure that agreements and payments that are not permitted by operation of the rule are subject to FHFA review and consent. In its review, FHFA applies the factors as appropriate to the facts and circumstances of a particular request, to determine whether an agreement or payment should be permitted or prohibited.

Review factors suggested by statute include whether there is a reasonable basis to believe that the affiliated party (1) has committed any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse, or has violated any provision of federal or state law, that has had a material effect on the troubled institution's financial condition, or (2) is substantially responsible for the troubled condition or insolvency of, or the appointment of a conservator or receiver for, the troubled institution. The current rule requires the regulated entities to consider these factors and an additional factor related to committing or conspiring to commit certain federal crimes, prior to submitting a request for consent. The rule also sets forth additional factors for the Director's consideration when reviewing requests (including two factors suggested by Section 4518(e) that address the affiliated party's position and length of affiliation with the regulated entity) and states that FHFA may consider any other factor that is relevant to the facts and circumstances, including any fraudulent act or omission, breach of fiduciary duty,

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<sup>57</sup> 12 U.S.C. 4518(e)(2).

violation of law, rule, regulation, order or written agreement, and the level of willful misconduct, breach of fiduciary duty, and malfeasance by the affiliated party.

FHFA is not proposing any changes to the rule factors that a troubled institution would be required to consider prior to submitting a request for FHFA's consent. FHFA is proposing to add three new factors for the Director's consideration, to reflect FHFA's understanding of the purpose of Section 4518(e) and other proposed changes to the rule.

As noted above, the legislative history and language of Section 4518(e) indicate it was intended to permit FHFA to prohibit or limit golden parachute payments that are excessive or abusive, or that would materially adversely affect the financial condition of the regulated entity. FHFA has always been guided by the purposes of Section 4518(e) in administering the rule, but proposes to add these factors now for transparency.

FHFA is also proposing to add as a review factor whether an agreement (including a plan) is usual and customary. FHFA believes this can be an important factor given that the regulated entities hire employees with special expertise and must compete in the market for such talent. While the fact that the requesting regulated entity considers a benefit to be usual and customary would not, alone, determine permissibility, it is a factor that would inform FHFA's review.

Also for transparency, FHFA is proposing to add a review factor for any other information submitted by a regulated entity. This factor has been implicit in the current rule, as FHFA routinely considers all information submitted with a request for consent, but it would now be explicit.

*FHFA Review Process.* Though FHFA is proposing relatively few changes to the rule's review factors, other proposed rule changes will affect when and how review

occurs. Specifically, if the rule is amended as proposed, it should result in a greater number of golden parachute payments being permitted by operation of the rule. As FHFA will not be reviewing these payments, it will not be applying the review factors to them. However, FHFA expects most payments that are permitted by operation of the rule to be those that are made in accordance with an agreement that is permitted, when the troubled institution is reasonably assured that the affiliated party to whom payment would be made has not engaged in the rule's listed types of wrongdoing. Under the rule as amended, most agreements would require FHFA's review to determine their permissibility (as they do now) and, when determining whether to permit the agreement, FHFA will consider the review factors as appropriate.

If amended as proposed, the rule would permit a troubled institution to enter into two types of agreements to make golden parachute payments without FHFA review: individually negotiated settlement agreements and agreements to make *de minimis* golden parachute payments, limited in each case to affiliated parties who are not executive officers. FHFA has considered whether application of the review factors would result in a determination that these agreements should be prohibited, and has determined it is unlikely.

For individually negotiated settlement agreements, FHFA believes the risk that the rule as proposed to be amended would permit an agreement that would be prohibited if subject to FHFA review is small because of the type of agreement, and because, to be permitted, the agreement must be with an affiliated party who is not an executive officer, where the troubled institution is reasonably assured that the affiliated party has not engaged in listed types of wrongdoing. FHFA's experience generally is that individually

negotiated settlement agreements reflect the unique facts and circumstances that gave rise to the dispute, as considered and weighed by parties with opposing interests in achieving the agreed-upon settlement. This may include consideration of factors similar to those set forth in the rule (such as type of wrongdoing suspected and position, duties, or responsibilities of the affiliated party) in addition to factors that are not generally applicable, such as the anticipated cost of litigating a dispute and the potential benefit of avoiding future, similar, actions by other affiliated parties. Where the affiliated party is not in a position to influence an unduly favorable settlement offer – as an executive officer may be, based on prior relationships with higher ranking employees authorized to negotiate or approve settlement offers – the fact that the parties are opposed also supports the conclusion that the agreed-to settlement payment is not abusive or excessive. If, in addition, the troubled institution is reasonably assured that the affiliated party has not engaged in the listed types of wrongdoing, then there is relatively little risk that it is settling a claim as to which FHFA would have such a significant supervisory interest as to prohibit the agreement.

For agreements to make *de minimis* golden parachute payments (and subsequent payments), the risk that the amended rule would permit an agreement that would be prohibited if subject to FHFA review is significantly minimized by limiting permissible agreements to affiliated parties who are not executive officers and capping the amount of the permissible payment. On past experience, FHFA has not had reason to prohibit such small payments on the basis that they were excessive or abusive, or that they would or could detrimentally impact the financial condition of the troubled institution. In contrast, FHFA has permitted small golden parachute payments to avoid imposing an excessive



hardship on terminating employees, such as small payments to employees terminated involuntarily but not for cause whose performance was excellent but whose length of service did not qualify them for participation in a severance pay plan, or forgiveness of a small indebtedness to the troubled institution of an employee who terminated voluntarily to care for a family member with a disability.

FHFA has also considered the likelihood that the rule as proposed to be amended would operate to permit payments that FHFA would prohibit, if subject to FHFA review. Where FHFA has determined to permit an agreement and the rule as amended would permit the troubled institution to make payments in accordance with that agreement *only* after it is reasonably assured that the affiliated party has not engaged in certain types of wrongdoing, then FHFA believes additional review at the time of payment is not warranted because, if review were required, FHFA would most likely allow the payment. Under the current rule, which does require review at the time of payment, FHFA has consistently permitted proposed payments to employees who are not executive officers, where the payment is in accordance with an agreement to which FHFA has consented and as to which the requesting regulated entity has submitted the rule's required certification about employee wrongdoing. FHFA has done so based on, among other things, the possible negative consequences of prohibiting such payments on the condition of the requesting regulated entity – in particular, its ability to retain a stable workforce, replace employees based on more usual attrition rates, and recruit employees without paying a wage premium. FHFA's experience is reflected in the rule amendments now proposed.<sup>58</sup>

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<sup>58</sup> The current rule's process of review of agreements and subsequent payments has been called a "double approval" process. When commenters previously objected to it, FHFA noted that it was appropriate because the condition of a regulated entity could change between the time an agreement was consented to

If amended as proposed, the rule would permit payments to be made without review of employee conduct related to the rule's listed types of wrongdoing at the time of payment, by either FHFA or the regulated entity, in three instances: settlement payments pursuant to permissible individually negotiated settlement agreements to any affiliated party, small value gifts to an executive officer, and *de minimis* payments to an affiliated party who is not an executive officer. For settlement payments, review of employee conduct would be required at the time the agreement is entered into and thus would occur in conjunction with FHFA's determining whether to permit the agreement. For small value gifts and *de minimis* payments, FHFA has determined that review should not be required based on the small size of the gift for executive officers and, though larger, the size of the *de minimis* payment in combination with the limitation of this provision to non-executive-officer affiliated parties, and the facts that such payments are usually infrequent and made to avoid undue hardship.

In sum, FHFA believes the rule as proposed to be amended appropriately identifies those golden parachute payments and agreements where FHFA review should occur, balancing FHFA's supervisory concerns with the burdens of administration and compliance. FHFA also recognizes the possibility that, in some few cases, the amended rule could operate to permit an agreement or payment that FHFA may have prohibited if it had been reviewed, however. Apart from prohibiting golden parachute payments and agreements through the rule, FHFA has other supervisory, remedial and enforcement

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and a payment is made. *See, e.g.*, 79 FR 4394, 4396 (Jan. 28, 2014). This is still the case. However, FHFA's experience administering the rule suggests that "double approval" should not be required as a matter of course for all payments because the burden imposed on the regulated entity and FHFA outweighs the supervisory benefit to FHFA of reviewing some types of payments or some payments in some circumstances.

authority that it may use to address improper payments or agreements and prevent them in the future. For example, if FHFA determined that a regulated entity did not have an appropriate process for entering into and administering agreements to make golden parachute payments to affiliated parties, FHFA could require the regulated entity to take corrective action, or FHFA could initiate an enforcement action. If an affiliated party obtained a golden parachute payment on the basis of a false representation about their actions while affiliated with the regulated entity, the regulated entity or FHFA could bring an action seeking restitution or reimbursement, or another legal remedy.

#### **IV. Section-By-Section Analysis**

##### **A. § 1231.1 – Purpose**

FHFA is proposing conforming changes to this section.

##### **B. § 1231.2 – Definitions**

*Affiliated party.* FHFA is proposing to change the defined term “entity-affiliated party” to “affiliated party” throughout the rule, to avoid confusion with other, different, statutory and regulatory uses of the term “entity-affiliated party.” FHFA is also proposing to amend the definition for purposes of golden parachute payments and agreements. For all regulated entities and OF, “affiliated party” would include all officers, directors, and employees, and any other person who the Director determined, by regulation or order, was participating in the conduct of the affairs of the regulated entity or OF.

For the Enterprises and the Banks, fewer parties would be covered by type of affiliation (*e.g.*, shareholders). FHFA believes it is unlikely that some of the named “affiliated parties” would receive payments contingent on termination, and the “catch-all”

for any person determined to be participating in the conduct of the affairs of the regulated entity makes including parties by type unnecessary.

For OF, the scope of the amended “affiliated party” definition would be broader than the current definition, which covers OF managers and officers but does not cover other OF employees, and which does not have a “catch-all” for OF. FHFA has determined that, with regard to OF, the “affiliated party” definition is unnecessarily narrow and should be aligned with the definition applied to the Enterprises and the Banks.

FHFA is not amending the substance of the existing “entity-affiliated party” definition for purposes of provisions of part 1231 that address indemnification payments. For that reason, FHFA is adding language to distinguish which portion of the “affiliated party” definition applies to which type of payment (golden parachute payments and indemnification payments).

*Agreement.* FHFA is proposing to add a new definition of the term “agreement,” to implement its intention to distinguish the rule as applied to *agreements* to make golden parachute payments from its application to golden parachute *payments*. The statutory “golden parachute payment” definition covers both agreements and payments, and FHFA’s rule covered, and will continue to cover, both agreements and payments.

*Benefit plan.* FHFA is proposing to remove the definition of “benefit plan.” The purpose of this definition was to list two types of plans that were exempt from the definition of “golden parachute payment:” “employee welfare benefit plans” as defined in section 3(1) of ERISA, and other “usual and customary plans.” The exemption for ERISA “employee welfare benefit plans” is being retained and relocated. FHFA

proposes to remove the exemption for “usual and customary plans” because the exemption was not self-executing in practice (*i.e.*, regulated entities submitted plans that they thought were “usual and customary” and thus exempt to FHFA for review and concurrence) and FHFA believes most “usual and customary plans” will now be covered by other proposed exemptions. If a plan that a regulated entity considers to be “usual and customary” is not covered by another exemption, the regulated entity could request FHFA’s consent to the plan in accordance with the rule.

*Bona fide deferred compensation plan or arrangement.* FHFA is proposing to amend the definition of “bona fide deferred compensation plan or arrangement” to remove duplicative material and relocate a timing requirement that, if met, makes the plan or arrangement exempt from the “golden parachute payment” definition. The timing requirement would now appear with rule provisions related to exemptions.

*Entity-affiliated party.* As addressed above, FHFA is proposing to replace the term “entity-affiliated party” with “affiliated party” throughout the rule, to avoid confusion with other, different, statutory and regulatory uses of the term “entity-affiliated party”.

*Executive officer.* FHFA is proposing to add a definition of “executive officer,” to implement an approach to golden parachute payments and agreements that, in some cases, distinguishes the treatment of an agreement with or payment to an executive officer from those to another affiliated party, particularly lower-ranking employees. For purposes of the rule, “executive officer” would be defined as it is in FHFA’s separate rule on executive compensation, at 12 CFR part 1230. Any person who is an “executive officer” for purposes of that rule, including any person deemed to be an “executive

officer” by the Director, would be treated as an “executive officer” for the Golden Parachute Payments rule. In addition, when applying the “catch-all” in the “affiliated party” definition, the Director could determine that a person participates to such a degree in the conduct of the affairs of the regulated entity as to warrant treating the person as an “executive officer” for purposes of the Golden Parachute Payments rule.

*Golden parachute payment.* FHFA is proposing to remove reference to an “agreement” from the rule’s definition of “golden parachute payment,” to implement FHFA’s intention to distinguish, in some cases, the treatment of an *agreement* to make a golden parachute payment from the treatment of the *payment*. FHFA is also proposing to remove the phrase “pursuant to an obligation of such regulated entity or the Office of Finance,” to clarify FHFA’s authority to prohibit (or limit) gifts or contributions that a regulated entity or OF is not obligated to make, but are nonetheless “in the nature of compensation.” Further, FHFA proposes to remove a list of triggering events, the occurrence of which would cause payments by a regulated entity to a terminating affiliated party to be “golden parachute payments,” from the “golden parachute payment” definition. The listed events would be replaced with the reference term “troubled institution” (which would be defined in the rule). This change is intended to improve the readability of the rule and is not substantive.

Finally, FHFA is proposing to change the placement, within the rule, of exemptions from the “golden parachute payment” definition. Following the structure of Section 4518(e), exemptions have been listed in the definitional section. As a legal matter, the effect of an exemption is that an agreement or payment that could otherwise be construed as a “golden parachute payment” is permitted without FHFA review and

consent and cannot be prohibited using authority conferred by Section 4518(e). Since the practical effect of an exemption is the same as if the agreement or payment were permitted by the rule, FHFA believes the rule will be easier to understand and apply if all permissible agreements and payments – whether they are permitted to implement a statutory exemption from the “golden parachute payment” definition or by operation of the rule – are located together. To accomplish this, FHFA is proposing to relocate exemptions to the rule’s substantive section.

*Individually negotiated settlement agreement.* FHFA is proposing to add a definition of an “individually negotiated settlement agreement” for agreements entered into to settle a claim, or avoid a claim reasonably anticipated, against a regulated entity by an affiliated party, which involve a payment and a release of claims. This definition is used in provisions of the rule permitting such agreements, and payments pursuant to them, provided certain conditions are met.

*Nondiscriminatory.* FHFA is proposing to remove the definition of “nondiscriminatory” from the rule. In the current rule, this definition applies only in the context of an exemption from the “golden parachute payment” definition for certain severance pay plans. Severance pay plans that did not meet that condition were subject to FHFA’s review, and, based on its experience conducting such reviews, FHFA has determined that severance pay plans should be subject to review. FHFA has also determined that the current definition of “nondiscriminatory” may not be appropriate if applied to other types of benefit plans, and thus that the definition should be removed.

*Payment.* FHFA is not proposing any changes to the rule’s definition of “payment.”

*Permitted.* FHFA is proposing to add a definition of “permitted” when used in the context of a golden parachute payment agreement, to describe those agreements that may be the basis for a payment that does not require FHFA review and consent. A “permitted” agreement is an agreement that is permitted by operation of the rule or to which the Director has consented after review.

*Troubled condition.* FHFA is proposing to remove the definition of “troubled condition” but would include that triggering event, and the factors that would cause a regulated entity to be in “troubled condition,” within a new definition of “troubled institution.”

*Troubled institution.* FHFA proposes to add a new defined term, “troubled institution,” to improve the readability of the “golden parachute payment” definition. The definition of “troubled institution” will include all of the events the occurrence of which at a regulated entity would cause agreements with or payments to terminating affiliated parties to be “golden parachute payments,” and will include all events that the current rule lists as defining “troubled condition.”

FHFA also proposes to add an interpretation of the phrase “or is made in contemplation of” to the “troubled institution” definition. That phrase is used in Section 4518(e) to refer to agreements or payments that are made before a regulated entity becomes a “troubled institution” but which would be “golden parachute payments” if they had occurred after the triggering event. This interpretation would establish a rebuttable presumption that an agreement or payment made in the 90 days prior to the regulated entity’s becoming a troubled institution is “made in contemplation of” becoming a “troubled institution” and thus is a golden parachute payment or agreement.



### C. § 1231.3 – Golden Parachute Payments

FHFA is proposing several changes to § 1231.3, which currently prohibits golden parachute payments unless they are permissible by operation of the rule or are consented to by the Director of FHFA. To reflect the proposed rule's distinctions between agreements and payments, the phrase "and agreements" would be added to titles, as appropriate.

*Prohibited golden parachute payments.* FHFA does not propose any changes to § 1231.3(a) other than to its title, which will now state "*In general, FHFA consent required.*" This subsection establishes the rule's overall approach of prohibiting any golden parachute payment or agreement unless it is exempt from the rule, permitted by operation of the rule, or permitted by FHFA after review. FHFA believes the title as proposed to be amended is a more appropriate reflection of FHFA's process.

*Permissible golden parachute payments.* FHFA proposes extensive revisions to § 1231.3(b), effectively replacing it. Section 1231.3(b) currently addresses permissible golden parachute payments and agreements. As amended, § 1231.3(b) would set forth those agreements and payments that do not require FHFA consent because they are statutorily exempted from the "golden parachute payment" definition. To reflect that substantive change, § 1231.3(b) would be renamed "Exempt agreements and payments."

*Exempt agreements and payments.* Exemptions to be set forth in § 1231.3(b) are being relocated from § 1231.2, which now presents them in conjunction with the "golden parachute payment" definition. FHFA is also proposing to amend some exemptions, however. First, FHFA is removing references to foreign law, which FHFA does not believe would be applicable to its regulated entities, from exemptions related to qualified

pensions or retirement plans and for certain severance or similar payments. FHFA is also removing an exemption for any “benefit plan,” consistent with its proposal to remove “benefit plan” as a defined term. ERISA “employee welfare benefit plans” currently within the “benefit plan” definition, and thus exempt, would now be included as a stand-alone exemption from the “golden parachute payment” definition. An exemption for “bona fide deferred compensation plans or arrangements” would be expanded, to include plans or arrangements that meet all definitional requirements other than one related to the timing of the plan’s establishment or material amendment, but to which FHFA consents after review. An exemption for severance pay plans that are “nondiscriminatory” and meet other conditions would be removed, as FHFA has found that the exemption is not realistically available for the market-based severance pay plans of its troubled institutions and, based on experience gained from reviewing such plans, FHFA believes most severance pay plans should be reviewed as a matter of supervisory policy.

FHFA is also proposing to add new exemptions for any “nondiscriminatory employee plan or program” as defined for purposes of an IRC provision on parachute payments, at 26 U.S.C. 280G, and for any other benefit plan that the Director determines to be nondiscriminatory. The statutory golden parachute payment definition includes an exemption for “nondiscriminatory benefit plans,” but that term is not defined. Incorporation of the IRC “nondiscriminatory employee plans and programs” provides FHFA and its regulated entities a common reference and aligns FHFA and IRC treatment for purposes of parachute payments. Because there could be other benefit plans that are “nondiscriminatory” but that are not included among the IRC “nondiscriminatory employee plans and programs,” however, the rule would also exempt those benefit plans

that the Director determines are nondiscriminatory, on request for review by a regulated entity.

*Golden parachute payment agreements for which FHFA consent is not required.*

To distinguish between agreements and payments, FHFA proposes to add subsections that separately address permitted agreements and permitted payments. Within the construct of the rule, an agreement or payment that is not exempt from the definition of “golden parachute payment” or permitted by operation of the rule must be submitted to FHFA for review and is prohibited without consent.

New § 1231.3(c) would address only agreements, and would establish three types of agreements that are permitted by operation of the rule. Proposed new § 1231.3(c)(1) would permit agreements with or plans covering any affiliated party, where the plan or agreement is directed or established by the Director exercising authority conferred by 12 U.S.C. 4617. Proposed new § 1231.3(c)(2)(i) and (ii) would address agreements that are permitted provided they are with an affiliated party other than an executive officer — individually negotiated settlement agreements that meet certain conditions, and agreements to make *de minimis* payments.

Provisions of the current rule at § 1231.3(b)(1)(ii) and (iii), on permitted agreements made to hire a person when the regulated entity is, or to prevent it from imminently becoming, a troubled institution, and permitted changed in control agreements, would be removed. These provisions are subsumed in the other proposed amendments.

*Golden parachute payments for which FHFA consent is not required.* Proposed new § 1231.3(d) would set forth the types of payments that are permitted by the rule.

Proposed new § 1231.3(d)(1)(i) and (ii) would address two types of permitted payments to any affiliated party, including an executive officer: payments pursuant to an individually negotiated settlement agreement, and payments pursuant to a permitted agreement, where the Director provided consent to the payment in conjunction with reviewing the agreement and any conditions established by the Director when consenting to the payment have been met. Proposed new § 1231.3(d)(2) addresses one other permissible payment to any executive officer, a gift valued at \$500 or less that recognizes a significant life event such as retirement.

Proposed new § 1231.3(d)(3) would address two other types of payments that could be made to affiliated parties other than executive officers without FHFA review. Section 1231.3(d)(3)(i) would permit payments above a *de minimis* amount to be made to any affiliated party other than an executive officer, where the payment is in accordance with a permitted agreement and the troubled institution is reasonably assured, after conducting appropriate due diligence, that the affiliated party has not engaged in certain types of wrongdoing listed in the rule. Section 1231.3(d)(3)(ii) would permit payments at or below the *de minimis* amount to be made to an affiliated party other than an executive officer without FHFA review.

FHFA is also proposing to clarify the standard that a regulated entity must meet when, in conjunction with a request for FHFA's consent to an agreement or a payment, it considers the behavior of the affiliated party to whom payment would be made. The rule's current standard could imply that a regulated entity may not request FHFA consent if it is not able to certify, with a high degree of certainty, that the affiliated party has not engaged in certain types of wrongdoing listed in the rule. FHFA is not proposing any

change to the types of wrongdoing listed, which are currently set forth at § 1231.3(b)(1)(iv)(A) through (D) and would appear in the rule if amended as proposed at § 1231.3(e)(1)(i) through (iv). However, FHFA is proposing new § 1231.3(e)(1) to clarify that the due diligence required of a troubled institution, when assessing whether the affiliated party engaged in the listed types of wrongdoing, should be appropriate to the level and responsibilities of the affiliated party.

Proposed new § 1231.3(e)(2) would set forth the standard that a troubled institution must meet with regard to its assessment and understanding of the affiliated party's behavior, and would operate in conjunction with other proposed provisions that would permit a troubled institution to enter into an agreement to make a golden parachute payment, or to make such a payment without requesting FHFA review. Specifically, § 1231.3(e)(2) would provide that a troubled institution must be "reasonably assured" that the affiliated party has not engaged in the listed types of wrongdoing.

Proposed new § 1231.3(e)(3) would require notice to FHFA if a troubled institution intended to enter into a golden parachute payment agreement or make a payment that would be permitted by the rule without FHFA review but was not able to do so because it cannot meet the "reasonably assured" standard, and thereafter determines not to submit a request for review. Such notice is intended to ensure that FHFA is informed of concerns about wrongdoing that rise to a level where the troubled institution is not "reasonably assured" so that FHFA may follow up with appropriate supervisory action, and would be required to be provided to FHFA within 15 business days after the troubled institution determined that it could not meet the required standard.

Proposed new § 1231.3(f) would set forth factors the Director would consider when reviewing requests for consent to make a golden parachute payment, or enter into an agreement. All of the factors in the current rule, at § 1231.3(b)(2)(i) through (iii), would be retained but would be re-numbered. In addition, two new factors would be added, to consider whether the golden parachute payment would be made in accordance with an employee benefit plan that is usual and customary and whether the golden parachute payment or agreement is excessive or abusive, or would threaten the financial condition of the regulated entity.

Proposed new § 1231.3(g) would permit, but not require, the regulated entities to increase the regulatory caps for permitted small value gifts and agreements and payments that do not exceed a *de minimis* amount. It would also set forth the formula that must be used, if a regulated entity elects to apply the inflation adjustment to increase the cap.

**D. § 1231.4 – Indemnification Payments**

Section 1231.4 of the current rule is reserved.

**E. § 1231.5 – Applicability in the Event of Receivership**

FHFA is proposing conforming changes to § 1231.5 of the current rule, which addresses the effect of the appointment of a receiver for a regulated entity on any consent or approval provided pursuant to the rule.

**F. § 1231.6 – Filing Instructions**

Section 1231.6 of the current rule sets forth instructions for filing requests for consent, including where such requests must be filed and their content. Minor amendments to § 1231.6(a), on the scope of the filing instructions, would conform to

substantive changes proposed to the rule. Likewise, § 1231.6(b), which addresses where to file a request, would be updated and amended to cover any required notice to FHFA.

Content requirements currently set forth in the rule at § 1231.6(c)(1) through (5) would be retained, but would be re-numbered (c)(2) through (6) because of the addition of a requirement that the request be in writing (this was previously implied by reference to a “letter request”; FHFA wishes to clarify that other forms of writing, such as email, would meet the requirement). Two new requirements would also be added to proposed § 1231.6(c)(7) and (8), to address specific types of agreements or payments (*i.e.*, an agreement that the troubled institution believes is a “nondiscriminatory benefit plan” exempt as a matter of law; and a “bona fide deferred compensation plan or arrangement” for which the troubled institution seeks re-application of the exemption). Whether a request should include information responsive to content requirements at § 1231.6(c)(7) and (8) will depend on the type of agreement that is being submitted for review.

A content-of-request requirement currently set forth at § 1231.6(c)(6), which addresses certification that a regulated entity must make when submitting a request, would be removed. A new requirement would be added at § 1231.6(c)(9), that the troubled institution requesting review of an agreement with an individual affiliated party or any payment state in the request either that the troubled institution meets the “reasonably assured” standard or, if it does not, the reasons why it does not and the further reasons why the troubled institution believes FHFA should nonetheless consent to the golden parachute payment or agreement.

Section 1231.6(e), which addresses FHFA’s response to a request, will be relocated to § 1231.6(d), to follow the content-of-request requirements. New subsection

(e) will address the content of the notice that must be provided to FHFA when a troubled institution is not “reasonably assured” that an affiliated party has not engaged in the rule’s listed types of wrongdoing but elects not to submit a request for consent to a golden parachute payment or agreement to FHFA for review. These requirements are intended to ensure that the notice informs FHFA of the results of the troubled institution’s due diligence and the basis for its concern that the affiliated party may have engaged in wrongdoing of a type listed in the rule in detail sufficient for an appropriate supervisory response, while not being overly burdensome on the troubled institution.

Section 1231.6 would also be amended to include a new subsection (f), to clarify that FHFA may waive any filing requirement set forth in the rule. FHFA recognizes that in some cases, for example, an oral request may be appropriate.

Finally, notice that FHFA may request additional information during the processing of a request would be re-located to new § 1231.3(g) and expanded to cover notices to FHFA, in addition to requests.

## **V. Differences Between Banks and Enterprises**

Section 1313(f) of the Safety and Soundness Act (12 U.S.C. 4513(f)), as amended by section 1201 of HERA, requires the Director, when promulgating regulations relating to the Banks, to consider the differences between the Banks and the Enterprises with respect to the Banks’ cooperative ownership structure; mission of providing liquidity to members; affordable housing and community development mission; capital structure; and joint and several liability. The Director may also consider any other differences that are deemed appropriate.



In preparing this proposed rule, the Director considered the differences between the Banks and the Enterprises as they relate to the above factors. The Director requests comments from the public about whether differences related to these factors should result in a revision of the proposed rule as it relates to the Banks.

#### **VI. Paperwork Reduction Act**

The proposed rule would not contain any information collection requirement that would require the approval of the Office of Management and Budget (OMB) under the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*). Therefore, FHFA has not submitted any information to OMB for review.

#### **VII. Regulatory Flexibility Act**

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation's impact on small entities. Such an analysis need not be undertaken if the agency has certified that the regulation will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). FHFA has considered the impact of this proposed rule under the Regulatory Flexibility Act. The General Counsel of FHFA certifies that this proposed rule, if adopted as a final rule, is not likely to have a significant economic impact on a substantial number of small entities because the regulation applies only to the regulated entities, which are not small entities for purposes of the Regulatory Flexibility Act.

#### **List of Subjects in 12 CFR Part 1231**

Golden parachutes, Government sponsored enterprises, Indemnification.

## **Authority and Issuance**

For the reasons stated in the Supplementary Information, under the authority of 12 U.S.C. 4511, 4513, 4518, 4518a, and 4526, FHFA proposes to amend part 1231 of Title 12 of the Code of Federal Regulations as follows:

### **CHAPTER XII—FEDERAL HOUSING FINANCE AGENCY**

#### **SUBCHAPTER B—ENTITY REGULATIONS**

#### **PART 1231—GOLDEN PARACHUTE AND INDEMNIFICATION PAYMENTS**

1. The authority citation for part 1231 is revised to read as follows:

**Authority:** 12 U.S.C. 12 U.S.C. 4511, 4513, 4518, 4518a, 4526, and 4617.

2. Revise § 1231.1 to read as follows:

##### **§ 1231.1 Purpose.**

The purpose of this part is to implement section 1318(e) of the Safety and Soundness Act (12 U.S.C. 4518(e)) by setting forth the factors that the Director will take into consideration in determining whether to limit or prohibit golden parachute payments and agreements and by setting forth prohibited and permissible indemnification payments that regulated entities and the Office of Finance may make to affiliated parties.

3. Revise § 1231.2 to read as follows:

##### **§ 1231.2 Definitions.**

The following definitions apply to the terms used in this part:

*Affiliated party* means:

- (1) With respect to a golden parachute payment:

- (i) Any director, officer, or employee of a regulated entity or the Office of

Finance; and

(ii) Any other person as determined by the Director (by regulation or on a case-by-case basis) who participates or participated in the conduct of the affairs of the regulated entity or the Office of Finance, provided that a member of a Federal Home Loan Bank shall not be deemed to have participated in the affairs of that Federal Home Loan Bank solely by virtue of being a shareholder of, and obtaining advances from, that Federal Home Loan Bank; and

(2) With respect to an indemnification payment:

(i) By the Office of Finance, any director, officer, or manager of the Office of Finance; and

(ii) By a regulated entity:

(A) Any director, officer, employee, or controlling stockholder of, or agent for, a regulated entity;

(B) Any shareholder, affiliate, consultant, or joint venture partner of a regulated entity, and any other person as determined by the Director (by regulation or on a case-by-case basis) that participates in the conduct of the affairs of a regulated entity, provided that a member of a Federal Home Loan Bank shall not be deemed to have participated in the affairs of that Federal Home Loan Bank solely by virtue of being a shareholder of, and obtaining advances from, that Federal Home Loan Bank;

(C) Any independent contractor for a regulated entity (including any attorney, appraiser, or accountant) if:

(1) The independent contractor knowingly or recklessly participates in any violation of any law or regulation, any breach of fiduciary duty, or any unsafe or unsound practice; and

(2) Such violation, breach, or practice caused, or is likely to cause, more than a minimal financial loss to, or a significant adverse effect on, the regulated entity; or

(D) Any not-for-profit corporation that receives its principal funding, on an ongoing basis, from any regulated entity.

*Agreement* means, with respect to a golden parachute payment, any plan, contract, arrangement or other statement setting forth conditions for any payment by a regulated entity or the Office of Finance to an affiliated party.

*Bona fide deferred compensation plan or arrangement* means any plan, contract, agreement, or other arrangement:

(1) Whereby an affiliated party voluntarily elects to defer all or a portion of the reasonable compensation, wages, or fees paid for services rendered which otherwise would have been paid to such party at the time the services were rendered (including a plan that provides for the crediting of a reasonable investment return on such elective deferrals); or

(2) That is established as a nonqualified deferred compensation or supplemental retirement plan, other than an elective deferral plan described in paragraph (1) of this definition:

(i) Primarily for the purpose of providing benefits for certain affiliated parties in excess of the limitations on contributions and benefits imposed by sections 401(a)(17), 402(g), 415, or any other applicable provision of the Internal Revenue Code of 1986 (26 U.S.C. 401(a)(17), 402(g), 415); or

(ii) Primarily for the purpose of providing supplemental retirement benefits or other deferred compensation for a select group of directors, management, or highly compensated employees; and

(3) In the case of any plans as described in paragraphs (1) and (2) of this definition, the following requirements shall apply:

(i) The affiliated party has a vested right, as defined under the applicable plan document, at the time of termination of employment to payments under such plan;

(ii) Benefits under such plan are accrued each period only for current or prior service rendered to the employer (except that an allowance may be made for service with a predecessor employer);

(iii) Any payment made pursuant to such plan is not based on any discretionary acceleration of vesting or accrual of benefits which occurs at any time later than one year prior to the regulated entity or the Office of Finance becoming a troubled institution;

(iv) The regulated entity or Office of Finance has previously recognized compensation expense and accrued a liability for the benefit payments according to GAAP, or segregated or otherwise set aside assets in a trust which may only be used to pay plan benefits and related expenses, except that the assets of such trust may be available to satisfy claims of the troubled institution's creditors in the case of insolvency; and

(v) Payments pursuant to such plans shall not be in excess of the accrued liability computed in accordance with GAAP.

*Executive officer* means an "executive officer" as defined in 12 CFR 1230.2, and includes any director, officer, employee or other affiliated party whose participation in

the conduct of the business of the regulated entity or the Office of Finance has been determined by the Director to be so substantial as to justify treatment as an “executive officer.”

*Golden parachute payment* means any payment in the nature of compensation made by a troubled institution for the benefit of any current or former affiliated party that is contingent on or provided in connection with the termination of such party's primary employment or affiliation with the troubled institution.

*Individually negotiated settlement agreement* means an agreement that settles a claim, or avoids a claim reasonably anticipated to be brought, against a troubled institution by an affiliated party and involves a payment in association with termination to, and a release of claims by, the affiliated party.

*Payment* means:

- (1) Any direct or indirect transfer of any funds or any asset;
- (2) Any forgiveness of any debt or other obligation;
- (3) The conferring of any benefit, including but not limited to stock options and stock appreciation rights; and
- (4) Any segregation of any funds or assets, the establishment or funding of any trust or the purchase of or arrangement for any letter of credit or other instrument, for the purpose of making, or pursuant to any agreement to make, any payment on or after the date on which such funds or assets are segregated, or at the time of or after such trust is established or letter of credit or other instrument is made available, without regard to whether the obligation to make such payment is contingent on:

(i) The determination, after such date, of the liability for the payment of such amount; or

(ii) The liquidation, after such date, of the amount of such payment.

*Permitted* means, with regard to any agreement, that the agreement either does not require the Director's consent under this part or has received the Director's consent in accordance with this part.

*Troubled institution* means a regulated entity or the Office of Finance that is:

(1) Insolvent;

(2) In conservatorship or receivership;

(3) Subject to a cease-and-desist order or written agreement issued by FHFA that requires action to improve its financial condition or is subject to a proceeding initiated by the Director, which contemplates the issuance of an order that requires action to improve its financial condition, unless otherwise informed in writing by FHFA;

(4) Assigned a composite rating of 4 or 5 by FHFA under its CAMELSO examination rating system as it may be revised from time to time;

(5) Informed in writing by the Director that it is a troubled institution for purposes of the requirements of this part on the basis of the most recent report of examination or other information available to FHFA, on account of its financial condition, risk profile, or management deficiencies; or

(6) In contemplation of the occurrence of an event described in paragraphs (1) through (5) of this definition. A regulated entity or the Office of Finance is subject to a rebuttable presumption that it is in contemplation of the occurrence of such an event during the 90 day period preceding such occurrence.

4. Revise § 1231.3 to read as follows:

**§ 1231.3 Golden parachute payments and agreements.**

(a) *In general, FHFA consent is required.* No troubled institution shall make or agree to make any golden parachute payment without the Director's consent, except as provided in this part.

(b) *Exempt agreements and payments.* The following agreements and payments, including payments associated with an agreement, are not golden parachute agreements or payments for purposes of this part and, for that reason, may be made without the Director's consent:

(1) Any pension or retirement plan that is qualified (or is intended within a reasonable period of time to be qualified) under section 401 of the Internal Revenue Code of 1986 (26 U.S.C. 401);

(2) Any "employee welfare benefit plan" as that term is defined in section 3(1) of the Employee Retirement Income Security Act of 1974, as amended (29 U.S.C. 1002(1)), other than:

(i) Any deferred compensation plan or arrangement; and

(ii) Any severance pay plan or agreement;

(3) Any benefit plan that:

(i) Is a "nondiscriminatory employee plan or program" for the purposes of section 280G of the Internal Revenue Code of 1986 (26 U.S.C. 280G) and applicable regulations;  
or



(ii) Has been submitted to the Director for review in accordance with this part and that the Director has determined to be nondiscriminatory, unless such a plan is otherwise specifically addressed by this part;

(4) Any “bona fide deferred compensation plan or arrangement” as defined in this part provided that the plan:

(i) Was in effect for, and not materially amended to increase benefits payable thereunder (except for changes required by law) within, the one-year period prior to the regulated entity or Office of Finance becoming a troubled institution; or

(ii) Has been determined to be permissible by the Director;

(5) Any payment made by reason of:

(i) Death; or

(ii) Termination caused by disability of the affiliated party; and

(6) Any severance or similar payment that is required to be made pursuant to a state statute that is applicable to all employers within the appropriate jurisdiction (with the exception of employers that are exempt due to their small number of employees or other similar criteria).

(c) *Golden parachute payment agreements for which FHFA consent is not required.* A troubled institution may enter into the following agreements to make a golden parachute payment without the Director’s consent:

(1) With any affiliated party where the agreement is directed or established by the Director exercising authority conferred by 12 U.S.C. 4617.

(2) With an affiliated party who is not an executive officer where the agreement:

(i) Is an individually negotiated settlement agreement, and the conditions of paragraph (e)(2) of this section are met; or

(ii) Provides for a golden parachute payment that, when aggregated with all other golden parachute payments to the affiliated party, does not exceed \$2500 (subject to any adjustment for inflation pursuant to paragraph (g) of this section).

(d) *Golden parachute payments for which FHFA consent is not required.* A troubled institution may make the following golden parachute payments without the Director's consent:

(1) To any affiliated party where:

(i) The payment is required to be made pursuant to a permitted individually negotiated settlement agreement; or

(ii) The Director previously consented to such payment in a written notice to the troubled institution (which may be included in the Director's consent to the agreement), the payment is made in accordance with a permitted agreement, and the troubled institution has met any conditions established by the Director for making the payment.

(2) To an executive officer where the payment recognizes a significant life event and does not exceed \$500 in value (subject to any adjustment for inflation pursuant to paragraph (g) of this section).

(3) Other payments to an affiliated party who is not an executive officer. A troubled institution may make a golden parachute payment to an affiliated party who is not an executive officer without the Director's consent in accordance with this part, where:

(i) The payment is made in accordance with a permitted agreement and the conditions of paragraph (e)(2) of this section are met; or

(ii) The payment when aggregated with other golden parachute payments to the affiliated party does not exceed \$2500 (subject to any adjustment for inflation pursuant to paragraph (g) of this section).

(e) *Required due diligence review; due diligence standard.* (1) *Agreements and payments where consent is requested.* A troubled institution making a request for consent to enter into a golden parachute payment agreement with, or to make a golden parachute payment to, an individual affiliated party shall conduct due diligence appropriate to the level and responsibility of the affiliated party covered by the agreement or to whom payment would be made, to determine whether there is information, evidence, documents, or other materials that indicate there is a reasonable basis to believe, at the time the request is submitted, that the affiliated party:

(i) Has committed any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the regulated entity or Office of Finance that is likely to have a material adverse effect on the regulated entity or the Office of Finance;

(ii) Is substantially responsible for the regulated entity or the Office of Finance being a troubled institution;

(iii) Has materially violated any applicable Federal or State law or regulation that has had or is likely to have a material effect on the regulated entity or Office of Finance;  
or

(iv) Has violated or conspired to violate sections 215, 657, 1006, 1014, or 1344 of title 18 of the United States Code, or section 1341 or 1343 of such title affecting a

“financial institution” as the term is defined in title 18 of the United States Code (18 U.S.C. 20).

(2) *Agreements and payments permitted without the Director’s consent.* No troubled institution shall enter into an agreement pursuant to paragraph (c)(2)(i) of this section or make a payment pursuant to paragraph (d)(3)(i) of this section unless it is reasonably assured, following due diligence in accordance with paragraph (e)(1) of this section, that the affiliated party to whom payment would be made has not engaged in any of the actions listed in paragraphs (e)(1)(i) through (iv) of this section.

(3) *Required notice to FHFA.* If a troubled institution determines it is unable to enter into an agreement pursuant to paragraph (c)(2)(i) of this section or make a payment pursuant to paragraph (d)(3)(i) of this section without the Director’s consent because it cannot meet the standard set forth in paragraph (e)(2) of this section, and thereafter does not request the Director’s consent to make the payment, then the troubled institution shall provide notice to FHFA of each reason for which it cannot meet the standard set forth in paragraph (e)(2) of this section, within 15 business days of its determination.

(f) *Factors for Director Consideration.* In making a determination under this section, the Director may consider:

(1) Whether, and to what degree, the affiliated party was in a position of managerial or fiduciary responsibility;

(2) The length of time the affiliated party was affiliated with the regulated entity or the Office of Finance, and the degree to which the proposed payment represents a reasonable payment for services rendered over the period of affiliation;

(3) Whether the golden parachute payment would be made pursuant to an employee benefit plan that is usual and customary;

(4) Whether the golden parachute payment or agreement is excessive or abusive or threatens the financial condition of the troubled institution; and

(5) Any other factor the Director determines relevant to the facts and circumstances surrounding the golden parachute payment or agreement, including any fraudulent act or omission, breach of fiduciary duty, violation of law, rule, regulation, order, or written agreement, and the level of willful misconduct, breach of fiduciary duty, and malfeasance on the part of the affiliated party.

(g) *Adjustment for inflation.* Monetary amounts set forth in this part may be adjusted for inflation, by increasing the dollar amount set forth in this part by the percentage, if any, by which the Consumer Price Index for all-urban consumers published by the Department of Labor (“CPI-U”) for December of the calendar year preceding payment exceeds the CPI-U for the month of [month prior to the month of publication in the Federal Register] 2018, with the resulting sum rounded up to the nearest whole dollar.

5. Revise § 1231.5 to read as follows:

**§ 1231.5 Applicability in the event of receivership.**

The provisions of this part, or any consent or approval granted under the provisions of this part by FHFA, shall not in any way bind any receiver of a regulated entity. Any consent or approval granted under the provisions of this part by FHFA shall not in any way obligate FHFA as receiver to pay any claim or obligation pursuant to any golden parachute, severance, indemnification, or other agreement. Nothing in this part may be construed to permit the payment of salary or any liability or legal expense of an

affiliated party contrary to section 1318(e)(3) of the Safety and Soundness Act (12 U.S.C. 4518(e)(3)).

6. Revise § 1231.6 to read as follows:

**§ 1231.6 Filing instructions.**

(a) *Scope.* This section contains procedures for requesting the consent of the Director and for filing any notice, where consent or notice is required by § 1231.3.

(b) *Where to file.* A troubled institution must submit any request for consent or notice required by § 1231.3 to the Manager, Executive Compensation Branch, or to such other person as FHFA may direct.

(c) *Content of a request for FHFA consent.* A request pursuant to § 1231.3 must:

- (1) Be in writing;
- (2) State the reasons why the troubled institution seeks to enter into the agreement or make the payment;
- (3) Identify the affiliated party or describe of the class or group of affiliated parties who would receive or be eligible to receive payment;
- (4) Include a copy of any agreement, including any plan document, contract, other agreement or policy regarding the subject matter of the request;
- (5) State the cost of the proposed payment or payments, and the impact on the capital and earnings of the troubled institution;
- (6) State the reasons why consent to the agreement or payment, or to both the agreement and payment, should be granted;

(7) For any plan that the troubled institution believes is a nondiscriminatory benefit plan, other than a plan covered by § 1231.3(b)(3)(i), state the basis for the conclusion that the plan is nondiscriminatory;

(8) For any bona fide deferred compensation plan or arrangement, state whether the plan would be exempt under this part but for the fact that it was either established or materially amended to increase benefits payable thereunder (except for changes required by law) within the one-year period prior to the regulated entity or Office of Finance becoming a troubled institution;

(9) For any agreement with an individual affiliated party, or for any payment, either:

(i) State that the troubled institution is reasonably assured that the affiliated party has not engaged in any of the actions listed in § 1231.3(e)(1)(i) through (iv), or,

(ii) If the troubled institution is not reasonably assured that the affiliated party has not engaged in any of the actions listed in § 1231.3(e)(1)(i) through (iv) but nonetheless wishes to request consent, describe the results of its due diligence and, in light of those results, the reason why consent to the agreement or payment should be granted.

(d) *FHFA decision on a request.* FHFA shall provide the troubled institution with written notice of the decision on a request as soon as practicable after it is rendered.

(e) *Content of notice to FHFA.* A notice pursuant to § 1231.3(e)(3) must:

(1) Be in writing;

(2) Identify the affiliated party who would receive or be eligible to receive payment;

(3) Include a copy of any agreement or policy regarding the subject matter of the request; and

(4) State each reason why the troubled institution cannot meet the standard set forth in § 1231.3(e)(2).

(f) *Waiver of form or content requirements.* FHFA may waive or modify any requirement related to the form or content of a request or notice, in circumstances deemed appropriate by FHFA.

(g) *Additional information.* FHFA may request additional information at any time during the processing of the request or after receiving a notice.

Dated: August 20, 2018.

Melvin L. Watt,  
*Director, Federal Housing Finance Agency.*  
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